Leveraging Connectivity to Innovate for a Differentiated Customer Experience

A Study into the Management of Interaction between Financial Services Organizations and their External Environment to enhance the Innovation Process for the Delivery of a Differentiated Customer Experience

by

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Declaration

I, the undersigned, hereby declare that the work contained in this assignment is my own original work and that I have not previously in its entirety or in part submitted it at any university for a degree.

Abstract

The high degree of extant commoditisation of organizations and their value propositions in the financial services industry has necessitated organizations in the industry to seek differentiation from the competition. Innovation has generally been accepted as a way for organizations to create differentiation by adding value to the organization.

Until recently the focus of innovation activities has been limited to the product or the service of the organization. Recent emphasis has however shifted the innovation mandate to more holistically consider the total experience the customer has when interacting with the organization.

This study concerns itself with the organizational activities required to innovate the customer experience. The main argumentation adopted by the thesis suggests that organizations need to constantly leverage their connectivity, forward and backward in value systems, across organizational boundaries to enhance the customer experience innovatively. Leveraging the organization's connectivity creates advantages for both radical and incremental innovation management to thereby improve and sustain the organization's profitability.

The study commences by critically analysing the total customer experience and then describing how the customer experience can create differentiation for the organization. The second part of the study scrutinises innovation literature to gain an understanding of how and where organizations can benefit in the management of innovation. The third part of the study reveals multi-channel management as a method that can be utilised to deliver the customer experience innovatively and benefit the organization in the continuous innovation of the customer experience.

The study culminates in a preliminary model that conceptualises the leveraging of connectivity in the innovation process necessary within the organization for the innovation of a differentiated customer experience. Limitations of the study are described, and recommendations are made for both further research and the application of the study to the business environment.

Opsomming

Ondernemings in die finansiële dienste industrie ondervind huidiglik dat hul waardeproposisies relatief maklik in kommoditeite verander. Dit noodsaak ondernemings in hierdie industrie tot toenemende innoverende differensiasie om daardeur 'n voorsprong op konkurrente in die mark te verkry. Innovasie word algemeen aanvaar as die manier waarop organisasies waarde kan toevoeg om sodoende differensiasie te bewerkstellig.

Tot onlangs was die fokus van innovasie-aktiwiteite beperk tot die produk of diens van 'n onderneming. Die moderne tendens is dat die klem in die innovasiemandaat verskuif om die totale ervaring in die interaksieproses tussen onderneming en kliënt holisties te benader.

Hierdie studie konsentreer op die organisatoriese aktiwiteite wat benodig word in die innoveering van die kliënt se ervaring. Die hoof argument wat deur die tesis aanvaar word, beklemtoon dat ondernemings deurlopend hul konnektiwiteit voor- en terugwaarts in die waardesisteem, moet hefboom oor organisatoriese grense heen, om daardeur die innovasieproses van die kliënte-ervaring te bevorder. Om die onderneming se konnektiwiteit op hierdie wyse te hefboom, skep voordele vir beide radikale en inkrementele innovasie bestuur waardeur die onderneming se winsgewendheid volgehou en verbeter kan word.

In die aanvang van die studie word gepoog om die totale verbruikerservaring krities te analiseer; daarna word uiteengesit hoe die kliënte-ervaring vir die onderneming differensiasie kan skep. Die tweede deel van die studie ondersoek literatuur wat betrekking het op innovasie om daardeur te verstaan hoe en waar ondernemings voordeel kan trek uit die bestuur van innovasie. Die derde deel van die studie stel multikanaal-bestuur voor as 'n metode om die beoogde kliënte-ervaring te weeg te bring, maar ook as 'n manier om die onderneming te bevoordeel in die deurlopende innovasie van die verbuiker se ervaring.

Die studie resulteer in 'n voorlopige model wat die hefboom van konnektiwiteit in die innovasie proses vir 'n gedifferensieerde kliënte-ervaring konseptualiseer. Ten slotte word die beperkings van die studie omskryf en aanbevelings word gemaak vir beide navorsingsdoeleindes, en die toepassing van die studie tot die praktiese sakeomgewing.

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Dedication

To God my Father,

and my parents who know Him.

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List of Abbreviations

Cap Gemini Ernst and Young	-	CGE&Y
Customer Experience Management	-	CEM
Customer Knowledge Management	-	CKM
Customer Relationship Management	-	CRM
Automatic Teller Machine	-	ATM
Short Message Service	-	SMS

PART ONE: THE CUSTOMER EXPERIENCE AS UNIT OF ANALYSIS

Chapter I

Introduction

1.1 Background to the study

Drucker's (1999, 25) argument that: "most financial products have become easily comparable commodities with decreasing profit margins", provides a good point of departure in examining the current state of strategic convergence in the financial services industry. Other authors have agreed with Drucker that financial products are increasingly commoditised and indicate to the necessity of a new financial services value chain in which companies should become either mass producers of products, or providers of products to the customer. These and other pressures in the environment have intensified the necessity for financial services companies to differentiate themselves from the competition (Bessellieu et al., 2001; Cordin et al., 2002; Ramamurthy and Robinson, 2002) for competitive survival and to thereby create a competitive advantage.

Research by Cap Gemini Ernst and Young's Centre for Business Innovation has indicated that innovation is one of the most important competitive differentiators (Chen, E. and Kai-ing Ho, K., 2002). Quinn et al. accordingly argue that "intellect and innovation are the sources of virtually all economic value, growth and strategic edge, today (Quinn et al., 1997, 1)". This research has been confirmed by other management studies (Hamel, 1998), but recently Prahalad and Ramaswamy (2003, 18) have asserted that innovation should concentrate on co-creating the customer experience, and not only on creating new products and solutions.

Research in the financial services industry by Bessellieu et al. (2001) has confirmed that the customer experience is particularly relevant to this industry and that organizations should increasingly consider innovation of the customer experience, with the strategic aim of creating differentiation in the mind of the customer. By coordinating innovation activities for the creation of a differentiated customer experience, organizations can benefit by increasing their financial performance, proliferating in higher profits (Pugh et al., 2002).

Innovation theory has suggested that long-term profitability depends on the ability of organizations to simultaneously manage radical innovation and incremental innovation (Tushman and Anderson, 1998). To successfully manage these divergent strategies organizations are required to create the appropriate context (Black and Farais, 2000) by leveraging their connectivity (Ruggles, 2002) across organizational boundaries with other organizations and with their customers.

Subsequent to innovating the customer experience, delivering and continuously co-creating the customer experience should occur through multi-channel management (Prahalad and Ramaswamy, 2003) by which the customer experience is synchronised and leveraged throughout the organization's various touch points. Multi-channel management should therefore be considered when innovating the customer experience and should be viewed as a natural outflow and enhancement of the customer experience.

1.2 Statement of the problem

Managerial scholars are currently analysing both:

a) how increased connectivity in the environment is influencing innovation (Ruggles, 2002; Rigby and Zook, 2002) as well as
b) the increasing involvement of the customer in innovation activities (Von Krogh, 2000; Chesbrough, 2003; Von Hippel, 2001).

Research in these areas has until recently neglected the role of the customer in service innovation, but more especially it has neglected the role of the customer in the innovation of the customer experience.

Acknowledgement is also gradually growing concerning the necessity for organizations to utilise an open innovation model (Chesbrough, 2003) to leverage connectivity and more effectively manage innovation. As connectivity is increasing and the ways to manage innovation is changing, the need arises to understand the influence of connectivity (Ruggles, 2002) on both incremental and radical innovation processes.

This understanding can benefit in the innovation of a differentiated customer experience (Prahalad and Ramaswamy, 2003) and assist organizations to continuously innovate and thereby remain strategically differentiated from the competition in order to gain a competitive advantage and be profitable over the long term.

The question therefore arises as to the necessity for organizations in the financial services industry to effectively manage their connectivity to customers and other organizations and thereby benefit in the innovation and the delivery of a differentiated customer experience throughout the channels of the organization.

1.3 Objective of the study

The objective of this study is the development of a preliminary model for the leveraging of connectivity to innovate for a differentiated customer experience, with the focus on selected organizations in the financial services industry.

1.4 Scope of the study

The study commences by examining the current state of the financial services industry and the evolvement of a new value chain within this industry. It then builds on this analysis to gain an understanding of how and where value is added in the organizational value chain to successfully differentiate the organization.

By gaining an understanding of the progression of economic value theory the study then defines and describes the customer experience as the focus area for strategic differentiation. The next part of the study then shifts to analyzing extant innovation theories and conceptualizes these theories in the context of the organization's need to sustain long-term profitability through radical and incremental innovation.

From a complexity theory perspective on innovation management the author then builds an understanding into how connectivity with customers and with other organizations across organizational boundaries can benefit the innovation process in the search for both incremental and radical innovation opportunities.

Finally the author explains how the innovation strategy should be implemented and delivered through the use of multi-channel management to synchronize the customer experience throughout the organization's areas of interaction (touch points) with the customer.

1.5 Methodology

This study makes use of an extensive secondary source analyses and is conducted through studying research published in books, journals, articles and relevant sources found on the Internet such as conference papers, governmental documents and web pages. The research methodology is qualitative in nature and was performed by using the University library and searching the Internet, as well as utilising resources provided by Cap Gemini Ernst & Young such as the Intranet and relevant internal documents.

1.6 Structure of the Presentation

The study is organised into four different sections. The first part systematically analyses the customer experience. The second part provides a theoretical background in innovation management and explains the necessity for connectivity in the innovation process from this background. Part three of the study concentrates on delivering the customer experience through utilization of multi channel management. The last section of the study relates the main findings, concludes the study and presents the model and the recommendations based on the model.

Chapter I is an introduction to the thesis, providing the background to the study. In this chapter the problem of the study is identified and the scope within which the problem would be studied is explained. After this the methodology with which the study would be conducted is explained and the structure in which the paper is written is provided. Lastly the chapter concludes in a summary of the chapter.

Chapter II illustrates the evolvement of the financial services industry and the current need of organizations in this industry to differentiate through adding value to the customer experience. This chapter sets the basic arguments for following chapters by explaining the necessity for differentiation through innovation, and further explaining how the innovation process is enhanced through organizational connectivity.

Chapter III studies the customer experience from a holistic perspective and provides the reader with a background to the strategic necessity for innovation of the customer experience. In this chapter the author explores research regarding the customer experience and the way in which the customer experience is currently being viewed with regards to the organization's overall strategy within the external environment.

Chapter IV analyses the progression of innovation theory from the basic entrepreneurial theory to that of complexity management. This chapter also provides the background and framework necessary for understanding and viewing the following chapters.

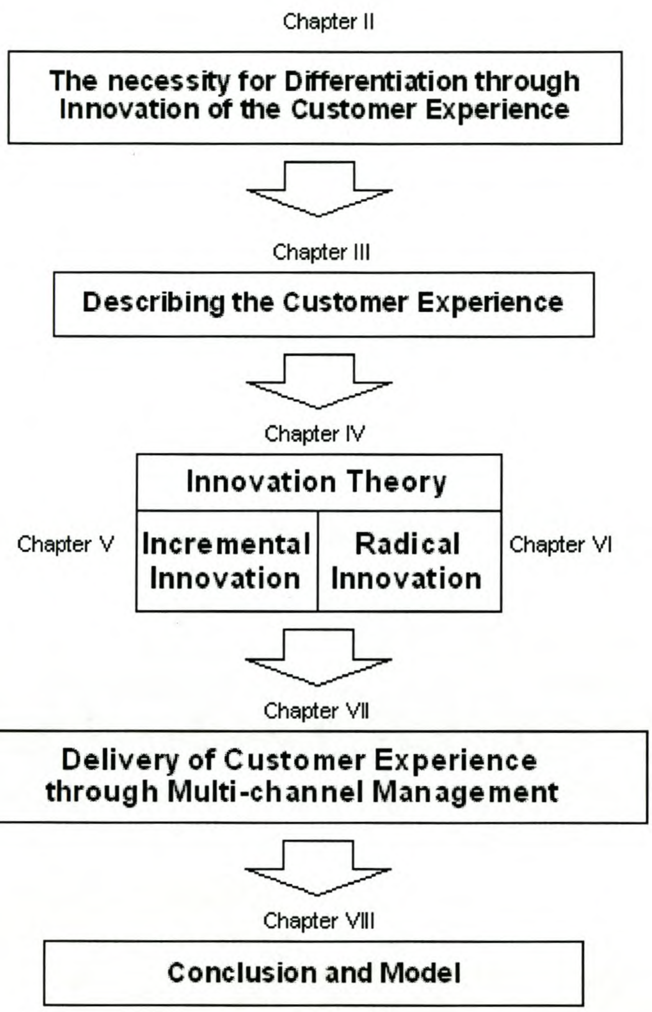
Chapter V explains the necessity to leverage customer knowledge management for continuous incremental innovation. The chapter analyses knowledge flows between the organization and the customer through various styles of customer knowledge management. It also indicates to how the customer can become involved, through the use of toolkits, in creating his own experience in the innovation process.

Chapter VI recognizes the need for organizations to manage and connect to external innovation sources, to enhance the fit between the innovation strategy of the organization and the external environment. This chapter regards the radical innovation strategy of the organization as critical for co-shaping the environment and enabling long-term profitability. It also explains why connectivity should be leveraged to increase the opportunity for radical innovation.

Chapter VII explores the utilization of multi-channel management as the process of delivering the customer experience of the organization throughout the organization's various touch points. This chapter makes the reader aware of the necessity for synchronization of the organization's touch points, the development of more appropriate customer segmentation and the necessity for customer interaction in the personalization of the customer experience.

Chapter VIII summarizes the major findings of the study and provides the study's conclusion and recommendations. This chapter also provides an adapted preliminary model based on the conclusions presented by the study. Fig. 1.1 provides the reader with an illustrative outline of the studies major chapters.

Fig 1.1: Outline of major chapters



1.7 Summary

This chapter commenced with a short introduction to the study and a statement of the problem area relating to the need for differentiation in the financial services industry. It then sets out the objective of the study and the scope within which the study will be completed. Finally it explains the research methodology utilized by the author along with a chapter-by-chapter summary of the presentation and a model illustrating how the study is structured.

Chapter II

The Necessity for Differentiation through Innovation of the Customer Experience

2.1 Introduction

This chapter commences by critically analyzing the need for organizations to create differentiation in the mind of the customer, by concentrating the value adding activities of the organization on the customer experience. The chapter provides the reader with a description of the current conditions necessitating differentiation in the financial services industry and then explains how and where value can be added in the value chain to create differentiation.

The chapter argues that the customer experience should be regarded as the strategic point of differentiation where value is perceived by the customer. The strategic coordination of the organization should therefore add value through focusing innovation activities and the delivery of the added value these activities bring, on the customer experience.

2.2 A short history of the financial services industry

Thirty years ago customer service in the financial services industry was based on an in depth knowledge of the customer. Bankers knew their customer intimately and also knew their needs or future needs. Customers did not compare prices and organizational loyalty was high. Between the 1980′s and 1990′s deregulation began to increase and with it greater competition. This led to a greater expansion of product offerings and an increase in fees charged by banks, so that in 1997 non-interest income increased to 67% of net income from 49% in 1991.

In the 1990's comparison-shopping was still difficult and many customers remained loyal to their firms. Increasingly banks began to invest in technology to increase cost effectiveness and simplification of banking operations. This simplification led to the formation of niche markets such as credit cards, but also created the opportunity for non-traditional financial services companies, such as manufacturing companies and retail companies, to enter the market. This simplification process unknowingly also led to easier comparison of products between different organizations which resulted in the commoditisation of products.

After this period of operational simplification the industry shifted to competing on scale. Through mergers and acquisitions companies sought dominance, but because of the necessity of investing in infrastructure, the cost of integration became higher than expected, resulting in increased expenses. Competitive intensity based on scale increased with the result that scale was no longer a competitive differentiator (Bessellieu et al., 2001).

It has been suggested that because of the above reasons organizations in the financial services industry, and more especially banks, are increasingly searching for a strategy that would differentiate them from the competition (Westlake, 2003).

2.3 The necessity for differentiation in the financial services industry

Various sources (Bessellieu et al., 2001; Cordin et al., 2002; Ramamurthy and Robinson, 2002) have indicated that financial products can be considered commodities in that they are easy to replicate and compare with one another. The speed in which new innovations in financial products are transformed into commodities is also increasing rapidly. Many financial products and services can currently only be differentiated on the basis of price, which makes comparison with competitors relatively unsophisticated (Bessellieu et al., 2001).

Drucker (1999) indicates that very little innovation has taken place in the financial services industry in the past 30 years. Product innovations that have occurred can mostly be viewed as financial derivatives and are more likely to be incremental improvements than innovations.

Drucker explains this process of commoditisation through the "Theory of economic development" in which Schumpeter argues that high "innovator's profits" from products attract many imitators to the market who sell commodities with low profit margins. This imitation with the resulting commoditisation then has a negative effect on the high profit margins of the innovator. Drucker thus confirms the findings of other authors that most Financial Services products have become commodities and have become less profitable to sell.

According to Marr (2003) customers still see very little differentiation in financial products and they increasingly search for differentiation in issues such as the relationship, accessibility and ease of use, after the product has been purchased.

Porter (1996) has argued that studying the competition and doing the same things they do in an improved way, will result in transforming organizational activities into commodities and will lead to competing through price differentiation (see Bachmann, 2002). Porter (1996) explains that doing things better in the quality, speed and productivity of an organization relates to improvements in operational effectiveness, but does not lead to long-term sustainability and cannot be defined as strategy.

Competing through operational effectiveness results in lowering the average unit costs, differentiating through the creation of value, in contrast, leads to greater average unit prices. Instead of doing the same things better, organizations should focus on doing things differently and thereby creating value. Porter emphasizes that: "the essence of strategy is choosing to perform activities differently than rivals do (Porter, 1996, 64)".

Prahalad and Ramaswamy (2003) argue that because organizations have controlled value creation activities, the organizational view of value has been dominant. As organizations are currently becoming more customer orientated, the customer's definition of value is increasingly being regarded as important. The market is also gradually shifting from being a passive recipient of value to an active participant in the customer experiences as value.

2.4 Areas of value creation in the financial services industry

Managerial thinkers have analyzed the financial services industry value chain to discover areas where value can best be added to the organization and how the organization can most effectively be structured to create value (Dyer et al., 2003).

The importance of interaction costs has been described as the major determination for how organizations seek to restructure themselves and their relationships with other organizations (Hagel II and Singer, 2000). The improvement of information technology has led to lower interaction costs which creates an urgency with organizations to structure themselves in ways which best utilizes information technology to minimise interaction costs. Information technology has further enabled central organizational activities to be outsourced to organizations that can do these activities faster and better. This has necessitated organizations within the value chain to increasingly question the type of business they are currently in.

Hagel II and Singer (2000) explain that within each organization there are three different businesses. The three businesses are that of: a) customer relationship management, b) product innovation and c) infrastructure. The combination of these businesses has in the past been regarded as essential to keeping down interaction costs. Hagel II and Singer (2000) now argue that these three businesses have inherently different economic goals and that, with the costs of interaction declining, it has become essential to separate these businesses.

Customer relationship management focuses on building relationships with customers. In the bank environment for instance this would include answering customer queries, processing information regarding customers and other customer facing activities such as sales and marketing. The employees in this business are directed towards attracting and maintaining relationships with customers over the long term. The customer relationship business is therefore orientated to continuing a long and profitable relationship with the customer and profits from this business are created through enabling economies of scope.

The product innovation businesses strength is in researching new products and services and understanding ways in delivering them to the market. Success in the product innovation businesses depends on the speed with which new products and services are brought to the market. Rapid delivery of new products and services to the market results in higher profit margins and greater potential market share.

The infrastructure business's economic viability depends on processing large volumes of repetitive activities. Within a bank this is found in the back office operations and in repetitive transactions such as deposits, withdrawals and issuing statements. The main orientation of the infrastructure business is in lowering costs through processing large volumes. The economic goal of the infrastructure business is therefore in reaching economies of scale.

From the above Hagel II and Singer (2001) reason that:

a) customer relationship management concentrates on customers,
b) product innovation on seeking and retaining talented employees and

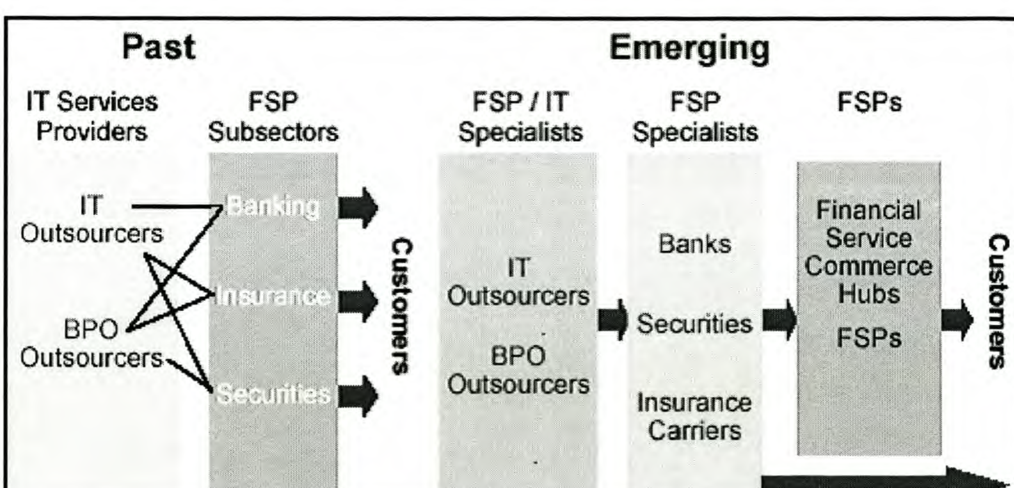
c) infrastructure on efficient operations that drive down costs.

The different goals of scope, speed and scale do not function optimally when combined into one business. The goals of customer relationship management are directed to placing the needs of the customer first through special treatment or customising offerings, while infrastructure in contrast seeks to treat everyone as equal and minimise costs. Bundling the three businesses together leads to trade-offs in economic goals.

The unbundling of the three businesses has already commenced in the banking credit card industry. Affinity groups such as American Airlines are concentrating on attracting and retaining customers, credit card organizations such as Capital One are specialising on product innovation and infrastructure is outsourced to infrastructure specialists such as First Data, who now process half of the credit card transactions in the United States.

This restructuring can also be viewed in the evolution of the current financial services industry value chain. A separation is taking place between financial service aggregators who supply products to customers, financial service provider specialists who produce products and financial service provider IT specialists concerned with business processes (Cordin et al., 2002, Fig. 2.1). Ramamurthy and Robinson (2002, Fig. 2.4) confirm the restructuring in the financial services value chain, but describe the three parts of the value chain as manufacturing, distribution and operations.

Fig. 2.1: Emerging value chain in financial services industry



Source: Cordin et al., 2002, 8

Swahney (2001) explains that organizations do not have to break down organizational boundaries between different business units or impose homogeneity on a business to improve the functioning of the value chain, but rather link databases together and coordinate meaningful product delivery. Swahney argues that when uniformity is forced on organizations it leads to unclear goals in the different business units. When organizational databases are synchronised a unified face can be presented to the customer while at the same time achieving operational efficiency.

As a result of the increased efficiency of information technology Swahney and Parikh (2001) conceptualise the organizational value chain increasingly functioning as a network. In the network value is created at the ends of the network, because it is here that information is utilised and becomes valuable. At the back-end of the network the organization's infrastructure becomes shared, while at the front-end of the network intelligence is distributed to where users are situated.

Top management ads value at the back end of the network by answering questions regarding the need for shared infrastructure, which extends across organizational boundaries, and by concentrating on organizational restructuring. At the front-end of the network customers, sales representatives and sales channels should be enabled to personalise intelligence in order to utilise it best for the needs they might have.

Swahney and Parikh explain that in a networked world money is made through managing interactions rather than performing actions. The middle of the network where actions are performed is therefore less valuable than the ends of the network where information is utilised in interactions. The middle of the network can therefore be perceived as hollow.

The Boston Consulting Group (Dyer et al., 2003) has stated that banking needs to undergo a fundamental paradigm shift to recognise the evolvement of value from the "back end" of banks to the "front end". Financial Service Providers should understand that the creation of a unique proposition in the minds of the customer depends on the development of the distribution "front end".

2.5 The necessity for innovation of the customer experience

Innovation remains central to differentiating a company from the competition (Chen, and Kai-ing Ho, 2002), but innovation should rather concentrate on creating value than on creating product variety. The problem in concentrating on creating product variety is that the company then has a product centric view of innovation and customer value creation is neglected. Today's organization should rather innovate to add value to the customer experience (Prahalad and Ramaswamy, 2003).

2.5.1 The increasing "blur" between product and service innovation

The definition between a product and a service has become increasingly "blurred" (Meyer and Davis, 1998), especially in innovation studies. Bryson and Monnoyer (2002) have summarised four broad approaches to innovation: the technologist approach, the integrative approach, the services-orientated approach and the theoretical approach. The most recent approach to innovation, called the integrative approach, has come to recognise the increasing similarities in the innovation of products and services.

Characteristics that are found with both products and services such as knowledge, technology, process and service, make it increasingly difficult to distinguish between a service and a product. When studying manufacturing companies the emphasis has shifted from a concentration on the production process to that of managing the knowledge component of the process. The production process itself can be outsourced and implemented relatively easily, but the knowledge involved in this process, such as engineering, design and marketing, has become the most important part of organising the process.

Two examples of products that are hard to distinguish from services are those of:

- Manufactured products that are combined with services, such as car insurance maintenance warranties and service agreements.

- Manufactured products such as credit cards that are utilised as the initial transaction to enter into a relationship with the customer. (Bryson and Monnoyer, 2002)

Meyer and Davis (1998) argue that the standardisation process services undergo makes them seem like products. Meyer and Davis view the main reason for the blurring between services and products as connectivity, which in this regard is defined as the electronic link that aligns the process of creating products with information databases. This connection has made it increasingly easy for services to become commoditised and be treated as products.

Norman and Ramirez (1993) agree that the distinction between products and services are falling away and that current offerings provide a combination of both products and services. The evolution of banking services is used as an example to explain the creation of new value offerings. In the past cash withdrawal was done in the bank branch and the teller fulfilled this function. With the ATM cash withdrawals have become self-service and the customer can now receive cash anytime and everywhere.

Norman and Ramirez explain that the new logic of value creation has three strategic implications:

- Firstly companies should mobilise customers to create value for themselves such as the example of the ATM where service is outsourced to the customer and the customer creates his own value.

- Secondly individual offerings require the reconfiguration of relationships and business systems. Value offerings are created through involving customers, suppliers, allies and business partners.

- Thirdly competitive advantage is created through a value creation system that mobilises activities to match the customer. To remain competitive organizations have to remain in dialogue with customers to enable continuous value creation.

2.5.2 Shifting the innovation mandate towards the customer experience

A report by CGE&Y on the financial services industry (Bessellieu et al; 2001) indicates that maintaining a strong relationship with customers requires the orchestration of customer experiences throughout the life cycle of the customer, through meeting specific customer needs. In the creation and design of the customer experience emphasis should be placed on organising multi-channel distribution to enhance customer convenience.

To create a differentiated customer experience, organizations need to take the issues facing the customer as a point of departure. An example in mortgages could therefore be the inclusion of services such as searching for a home, helping with relocation and assisting in home insurance. In order to provide these added services the organization therefore needs to be involved in connecting with strategic partners across organizational borders and regarding the customer experience as central in designing its offerings (Bessellieu et al., 2001).

Managers should regard the product as subordinate to the experience the customer undergoes. Thus the product should be able to evolve to the needs of the customer and the customer should not need to adapt to the level of sophistication of the product (Prahalad and Ramaswamy, 2000).

CGE&Y has (Bessellieu et al., 2001) indicated two ways for financial services to achieve sustainable competitive advantage and differentiate themselves from the competition in the evolvement of the current value chain:

- Become a producer of superior products by competing as a commodity player or a niche player. Commodity players compete in a high volume market but compete by having low profit margins while niche players compete by providing value-added products and services and receive higher margins on lower sales volume. Drucker (1999) also indicates to seizing valuable market niche's yet the problem with focusing on market niches is that it is only profitable until competitors notice the profit potential and then commence competing for it.

- The second route is to differentiate in orchestrating a superior customer experience by addressing the customer relationship and the needs specific customer segments have. To offer a superior customer experience companies need to leverage the knowledge of their customers in order to fulfil their expectations (Bessellieu et al., 2001).

2.5.3 Managing innovation to create a differentiated customer experience

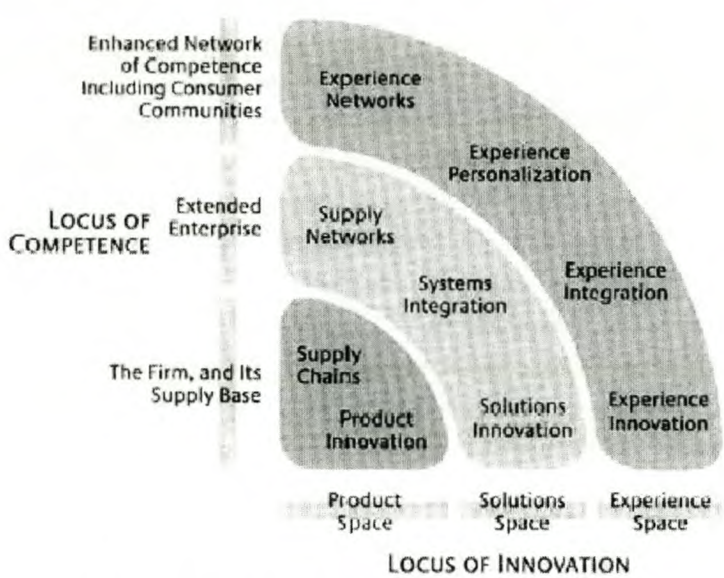
Prahalad and Ramaswamy define value creation as "the experience of a specific consumer, at a specific point in time and location, in the context of a specific event (2003, 14)". Prahalad and Ramaswamy argue for a change in managerial thinking to where innovation and value creation is connected through an experience space in which the company co-creates value through customer interaction.

The locus of innovation is therefore shifting from an emphasis on:

a) product innovation, to
b) innovation of a solution and now to
c) innovating for an enhanced experience.

Companies have now come to a stage where they should consider incorporating the customer experience into their business models. The shifting locus of innovation and competence is shown in Fig. 2.2.

Fig 2.2: The new competitive space for innovation.



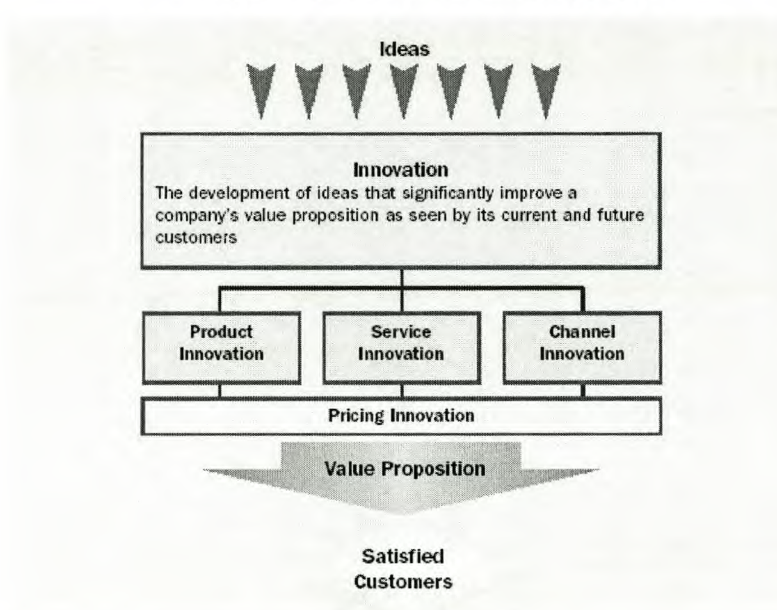
Source: Prahalad and Ramaswamy, 2003, 16

MacMillian and McGrath (1997) explain that a company has the ability to differentiate itself at each contact point between the organization and the customer. Through understanding the entire experience that a customer has with a product or service, or the experience throughout the consumption chain of the customer, organizations can differentiate themselves in positioning their offerings to customers.

MacMillian and McGrath suggest two methods for identifying points of differentiation. Firstly by "mapping the consumption chain" (1997, 133) to gain an understanding of the total experience a customer undergoes with a product or service and secondly by "analysing the customers experience" to understanding the ways interaction takes place. The interaction a customer has with the employees, activities or offerings creates feelings the customer has at certain links in the chain.

Innovation has been defined by Sievewright et al. (2003, 1) as "the process of developing and implementing ideas to improve customer experience, with the ultimate goal of enriching the companies value proposition as seen by its current and future customers". Innovation takes place in the areas of product, service, channel and pricing and each of the areas might influence the competitive position of the firm (Fig. 3.2). They further state that companies that focus on innovation have a competitive advantage regarding customer loyalty, retention and return on shareholder investment.

Figure 2.3: The innovation process



Source: Sievewright et al., 2003

2.5.4 Leveraging connectivity in the innovation of the customer experience

Prahalad and Ramaswamy (2003) argue that within the marketplace the emphasis on competence is shifting and corporations would increasingly need to look to customers as a new source of competence. The search for competence has shifted when companies first began to realise that they can also utilise the competencies of their suppliers and distributors, now the view of managers need to be further extended to also include the competencies of customers.

The advent of business discontinuities such as "deregulation, globalisation, technological convergence and the evolution of the internet" has come to "blur" the roles between companies and customers. Customers are not only increasingly interacting with manufacturers and producers of products and services, but they are further also conducting research and partaking in discussions with other customers about products and services. (Prahalad and Ramaswamy, 2003)

Ruggles (2002) indicates that if existing ideas are combined in a new way or in a different context, it opens up new possibilities. This recombination of ideas functions best when interaction is fully optimised between different parties and a greater degree of connectivity enhances this recombination of ideas.

Ruggles provides two ways in which to take advantage of connectivity and enhance the development of innovation. The first is that of networked innovation and focuses on the interaction between companies. Companies therefore can concentrate on their own competencies and at the same time outsource competencies that are less fundamental now, but might become important in the future. Links can be strengthened as the need arises depending on the uncertainty in the external environment. The second method is through distributed innovation in which virtual teams can work together on a project. This is often called open source innovation and has recently received a lot of academic attention.

In Quinn's (2000) research on outsourcing innovation he has found that organizations giving proper attention to innovation outsourcing interfaces upstream and cooperation with distributors downstream can decrease their innovation costs and increases the value of the innovation to the customer.

Cordin et al. (2002) argues that collaboration will become an important value proposition in the future financial services industry. As information increases in importance the relevance to both the timeliness as well as the value of the information is important. Financial Services Providers are therefore realizing that inter- and intra- organizational connectivity is important for continued success to be able to access this information.

Bessellieu et al. (2001) explain the greater need for collaboration by stating that organizations that wish to design customer experiences need to offer customers the opportunity to choose from both complementary and competing products. Ramamurthy and Robinson (2002) further predict that in the new market place collaboration will increasingly take place between financial services competitors, technological companies and non-traditional financial services providers to achieve competitive advantage in a certain area.

Further benefits realized by collaboration in the financial services industry include:

- Revenue growth through cross sales opportunities and broadening market reach
- Cost savings through resource sharing, creating more cost effective delivery channels and productivity gains.
- Supporting the development of new products and innovation as well as having joint marketing opportunities and channel collaboration.
- Improved communication and customer services by becoming more customer centric.
- The access to real time information and skills from experts
- Shared back office services and knowledge optimization (Cordin et al., 2002).

Prahalad and Ramaswamy (2003) argue that a new innovation mandate is now necessary in which the competence base of the organization and the organizational network is utilised to "expand and enhance" the experience of the individual customer and not only concentrate on the product or the solution the customer receives.

2.6 Orientating the organization towards the innovation approach for sustaining long-term profitability

To understand when to use an interactive strategy two major schools of thought on strategic management should be regarded. The one school asserts that an innovation orientation that creates new products and discontinuous improvement is needed in order to create customers and provide them with the best value and quality. The other school encourage organizations to have a customer orientation that concentrates on the needs of the market and supplies the products to satisfy these needs (Berthon, 1999). The innovation orientation therefore concentrates on creating markets for customers while the customer orientation places emphasis on understanding the current market needs.

The combination of these orientations is best described in the term "Ambidextrous Organization" which indicates to the need of organizations to manage for both today's needs and the needs of the future (Tushman and Anderson, 1997). An Ambidextrous organization incorporates the ability to manage for both incremental innovation such as product changes and for radical innovation. Radical (discontinuous) innovation is defined as competence destroying innovation where the method of doing things is changed, where as incremental (sustaining) innovation is viewed as competence enhancing innovation where improvements are made on a regular basis (Christensen and Overdorf, 2000; Hamel, 1998).

The two different strategic approaches can also be analysed according to research done by Von Krogh et al. (see Nonaka, 2000) which suggests that there are essentially two types of strategies, survival strategies and advancement strategies. "Survival strategies secure current strengths of the company", it "emphasizes current strengths and minimises current weaknesses." Advancement strategies in contrast focus on securing future profitability, "their aim is to take advantage of future business opportunities and neutralize future threats in the environment (Nonaka, 2000, 71 – 73)."

Berthon et al. (1999) categorise the orientations a firm can follow into four orientation modes:

- Isolate

  Organizations that fall into this category have very little communication with the market and are mostly inwardly focused. The organization tends to follow its own route and product development takes place separately from the market place, because of this inward orientation these organizations do not concentrate too much on either innovation or customers.

- Follow

In the follow mode the organization is centrally customer focused and the organization follows the needs and desires of the customer. The firm is normally involved in intensive market research, which is done formally and informally. In this mode customers are seen as the main focal point of all decisions. Examples of this mode include Marriot hotels, which asked their customers to conceptualise the best budget accommodation.

- Shape

The shape orientation suggests that customers may at times not know what technology is available and therefore also not know of the needs that this technology can satisfy. What is important in the shaping mode is that preferences and expectations can be formed. The shaping strategy can take place in two methods. Firstly through defining a market in which the organization creates a new market. The second method is in influencing the market as to what to expect but not necessarily dominating the market.

- Interact

In the interact strategy a dialogue is created between the market and technology. A tailor for example interacts with the client, through means of dialogue, regarding the product. In this way the client and the tailor "co-create the product". The emphasis in this approach is therefore on relationship marketing in which there is a learning relationship between the customer and the organization. Further evolvement in this dimension includes "mass customisation" as done by Dell and Levi. These companies use information from customers to tailor their products to their specific needs and requirements.

When choosing the most appropriate mode to function in organizations need to be aware of which environment they are currently operating in. Even though certain modes of operation might seem more virtuous than other there is the need to consider certain factors in the external environment that can facilitate determining in which mode to function.

The factors to consider can be categorised into the four groups namely:

a) environmental factors,
b) economic power of existing customers,
c) competitive factors and
d) political factors.

When functioning in a stable environment the isolate mode of operation can be considered as the most appropriate a mode of operation. The interactive mode might be considered when customer needs are high and a great variety of substitute technology is available. When the economic power of customers is high they are in a better position to determine market demands and the trend in this case there is to operate in a follower mode. In an unstable competitive environment where globalisation and de-regulation is taking place there is the need to function in a mode such as a shaping mode or interaction mode that might lead to better success in these environments. In certain situations political factors such as trade unions or board members might exert influence on the organization to change while top management remains dominant in their choice regarding the mode in which the organization should function.

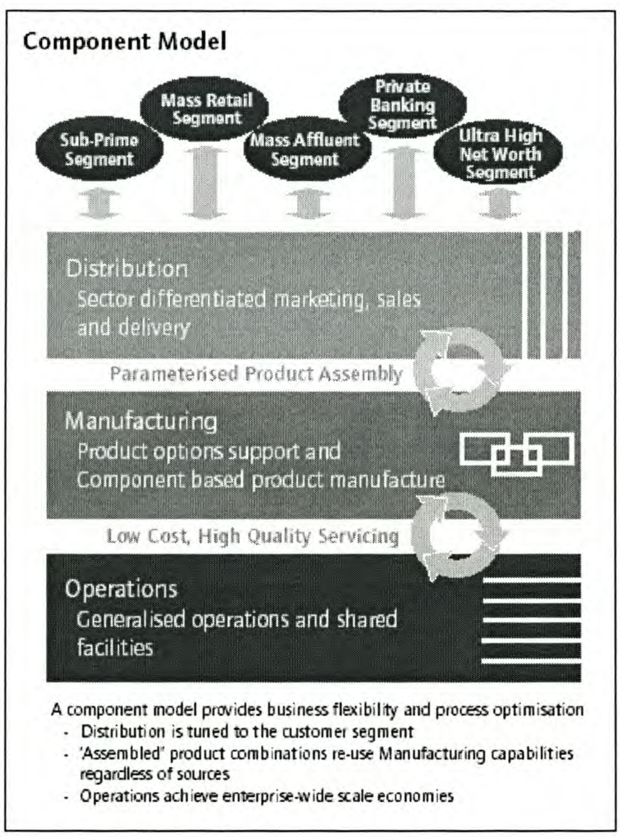
What is important is that the modes of orientation should be understood in the context of the environment in which it competes. Concentration should therefore not be on becoming customer orientated or innovation orientated but rather in understanding the environment and responding with the appropriate strategy. (Berthon et al., 1999) Gibbert et al. (2002) agree that companies should sense the wider environmental influences and not become over reliant on customer knowledge when managing innovation.

2.7 The process of delivering the customer experience

According to Ramamurthy and Robinson (2002) organisation in the future will mostly be done according to customer segments instead of products and channels. This organisation according to customer segments will be based on an understanding of the customer and the lifetime value of the customer. "The five major customer meta segments will be sub-prime, mass retail, affluent, high net worth and ultra high net worth (Ramamurthy and Robinson, 2002)." Service Providers will therefore have to redesign their customer facing part of the value chain around the customer segments in order to be successful, figure 2.4 (Ramamurthy and Robinson, 2002).

In managing the personal experience organizations would need to consider that there are various channels in which to reach the customer. Managers also need to keep in mind that the variety of the experience needs to be managed with the evolution of the customer needs and lastly that customer expectations should be addressed through customer interaction (Prahalad and Ramaswamy, 2000).

Figure 2.4: Component based model focused on customer segments



Source: Ramamurthy and Robinson, 2002

Organizations would need to have a greater understanding into the channels through which the customer wants to be reached. The cost reduction banks undergo when customers do banking transactions via a PC can be up to 80%, yet research has shown that the environment in which the transaction is done is also important to the customer experience. Wells Fargo made a big error in forcing PC banking on their customers, because of that customers became dissatisfied and profits from the organization fell.

Charles Schwab understands that many of their customers are still reached through their branches. Here personalised educational discussions are implemented to reach many of these customers, but there is also the understanding that direct channels can be utilised to reach other customers.

Multi-channel distribution networks therefore needs to be developed in order to reach every customer individually (Prahalad and Ramaswamy, 2000). Gronover and Riempp (2001) have explored the importance of multi-channel management and have found that knowledge about customers, as well as knowledge regarding the activities of customers, plays an important role in distributing products and services to the customer. They have further discovered that in future the management of interaction processes between the customer and the company will gain increased importance, because of the development of technology that increases the interaction possibilities.

It can therefore be understood when Bessellieu et al. (2001) concludes that companies need to design a differentiated experience for customers and make it applicable to every channel through which the organization and the customer meets.

In the process of transformation towards an enhanced customer experience there are three steps to follow. The first step involves building an understanding of the customer through two-way communication in which the organization should be the listener. In the second step the organization should be designed flexibly enough to meet the needs understood in step one and the third step should focus on investing in a delivery capability that meets the customer's expectations (Bessellieu et al., 2001).

2.8 Summary

This chapter commenced by introducing the reader to the highly competitive nature of the financial services industry, which leads to the perception that most of the products in this industry can be viewed as easily comparable commodities. From this perspective the study then argues that organizations seeking long-term profitability should focus attention on creating differentiation. This creation of differentiation most effectively occurs through the activities that organizations are involved in.

The current financial services value chain can be conceptualised as a network in which value is created at the front end of the network and at the back end of the network. Value is however increasingly being created at the front end of the network in the parts facing the customer. Organizations seeking to differentiate should therefore concentrate their value creation activities on the parts of the value chain in which the most value is created.

Differentiation ultimately occurs in the mind of the customer when exercising a decision on buying from the organization that has offered the best-perceived customer value. Innovation has been suggested as the best way through which organizations can create value to differentiate themselves. Organizations should however not be narrowly focused on product innovation or service innovation but should rather holistically perceive the total customer experience as the focus point of innovation activities. The value creation system of the organization should therefore align the mobilisation of all the innovation activities of the organization with the total experience of the customer.

The experience that a customer undergoes can be conceptualised as occurring in an experience space. To effectively innovate the experience space organizations are required to leverage their connectivity to the organizational network, which includes utilising both the competencies of the customer and the competencies of external organizations. Value is therefore created in the innovation activities that occur when interacting across organizational boundaries, incorporating both the competencies of the customer and other organizations in the innovation process for a differentiated customer experience.

Organizational innovation activities can range between two broad innovation approaches namely advancement strategies and survival strategies. Advancement strategies direct the organization towards aiming at future business opportunities, while survival strategies focus on strengthening the organization's current business activities. These approaches can further be classified into four orientation modes that organizations can apply towards their customers and towards the environment. The mode of orientation the organization needs to follow depends on the current environmental conditions an organization is competing in.

Organizations are therefore required to make sense of environmental influences and accordingly orientate towards the best strategic innovation approach. This does not indicate that organizations totally neglect one approach in favour of another, but rather that organizations function ambidextrously and apply both approaches while orientating their innovation activities to the most needed approach.

Subsequent to choosing the approach or strategy for the organization's innovation activities, delivery of the customer experience needs to be implemented. This delivery is executed through multi-channel management through which the organization directs the channels of the organization according to the customer segmentations. Multi-channel management should manage the interaction needs and expectations the customer has with the organization, thereby continuously creating value in the front end of the organization through the customer's interaction experience with the organization.

Chapter III

Describing the Customer Experience

3.1 Introduction

Chapter III seeks to provide a comprehensive background and analysis of theory regarding the customer's experience. The chapter commences by providing the reader with an overview of the theory of economic value creation and then subsequently analyses the characteristics regarding the total customer experience.

Literature relating to the customer experience then systematically examines the emphasis of the customer experience, from a subcomponent of Customer Relationship Management relating to the brand of the organization, to an interactive value creation strategy between the customer and the organizational network in which the customer becomes the co-creator of his own experience.

3.2 Understanding the progression of economic value creation

Various authors have recently come to concentrate on the customer experience (Haeckel, Carbone and Berry, 2003; Schmitt, 2003, Prahalad and Ramaswamy, 2003). Various perspectives including that of brand extinction within the CRM context (Kirby et al., 2003), innovation management (Prahalad and Ramaswamy, 2003) and a strategic orientation (Haeckel et al., 2003) have been used to define the total customer experience. All this research agrees that correctly managing the customer experience creates superior customer value.

Pine II and Gilmore (1998) argue that those who compete on goods and services may lose competitive advantage due to business innovation that is transforming the economy to that of an experiential economy. The transformation to an experiential economy is steadily occurring through the "progression of economic value". As goods are becoming standardized, they become commodities and the need arises to compete through services. Competing by providing excellent services again leads to standardisation and that turns the service into a commodity.

The next step in the progression of economic value involves competing through service customisation. In this stage competitive advantage is achieved by turning the service into an experience. Pine and Gilmore (2000) argue additionally that experiences can also be customised, which will create the need for organizations to commence competing through offerings transformations.

The theory of economic value progression is simplified by using a birthday cake as an example. In the past mothers baked birthday cakes for their children from basic inexpensive individual products. At a later stage premixed ingredients for the cake were bought and used adding a little more expense. In the service economy customers went to the local bakery to buy a cake at almost double the price of making their own cake. Currently in the experience economy the whole birthday is outsourced to an event organiser in which the cake is only one small part of the whole experience.

Pine II and Gilmore (1998) elaborate the example further by comparing the customer experience to going to the theatre. In this example the services set the stage and the goods can be seen as the props that are used. Experiences differ from goods and services in that the experience engages the mind of the individual, because experiences differ from individual to individual. Goods and services in contrast remain relatively similar from customer to customer.

A Gartner Research report differentiates between a service and an experience and agrees with Pine II and Gilmore (1998) when indicating that the experience is a step forward in the "progression of economic value". After designing the customer experience the process needs to be managed through combining stimuli that creates "feelings" with the customer.

Pine II and Gilmore (2001) add transformation as the third step in the progression of economic value. They explain this progression with an example from the insurance industry:

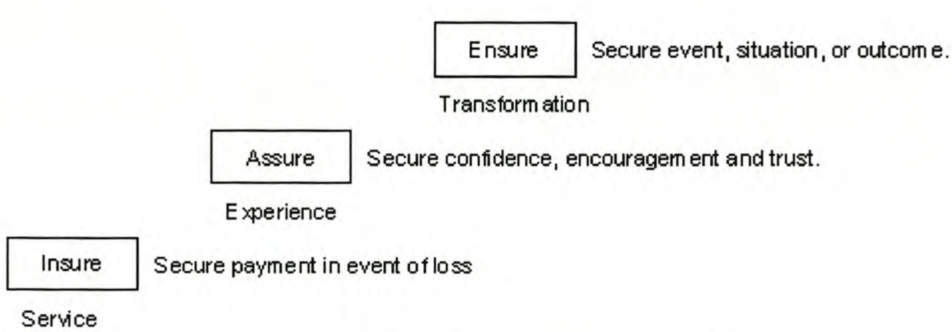
> Currently most insurance companies provide insurance that covers the customer when a loss occurs by providing compensation for the loss. Progressive Insurance of Cleveland utilise minivans fitted with computers and other technology to enable the company to resolve claims from the site of the accident. The claimant immediately receives a check from the company, but other than that also receives a cup of coffee and the ability to

phone friends and family from the minivan and to let them know that he is safe. The insurance company thus "assures" the policyholders and creates confidence and trust in the ability of the company. Not only do policyholders get compensation for the damages, but they can also be assured that their needs are addressed.

The next step in the progression of economic value would therefore be to insure policyholders by minimizing the risk of situations. This would involve the cooperation between the customer and the company in transforming the customer to become less risk averse. This process occurs in MII Companies Inc. that insures hospitals and physicians against malpractice. MII utilises analytical programs, educational classes and consultants to help minimise the risk of the customer.

Through co-operation between the company and the customer, the customer is therefore transformed to become less risk averse. Figure 3.1 illustrates the successive economic offerings in the insurance industry.

Figure 3.1: The successive economic offerings



Source: Pine II and Gilmore, 2001

3.3 Characteristics of the customer experience

Design, marketing and delivery is just as important to experiences, as they are to goods and services, but there are also characteristics that differentiate the experience offering and that should be considered. Pine II and Gilmore (1998) analyse experiences from two different dimensions:

- The first dimension involves customer participation that ranges between:
  a) passive participation with low or no level of customer participation and
  b) active participation where customers are fully involved in adding to the experience.

- The other dimension is described as the "connection" or "environmental relationship" between the customer and the event. When the customer absorbs the experience, the distance between the experience and the customer is greater that when the customer is immersed in an event. With the Kentucky Derby for example, the people on the stands absorb what takes place below them, while people next to the track have a much closer experience of the event and are immersed in what takes place.

The dimensions can be further conceptualised as occurring in four realms. Pine II and Gilmore illustrate the differences in the realms of the experience, by the use of a model (Fig 2.3). The four realms can be categorised as:

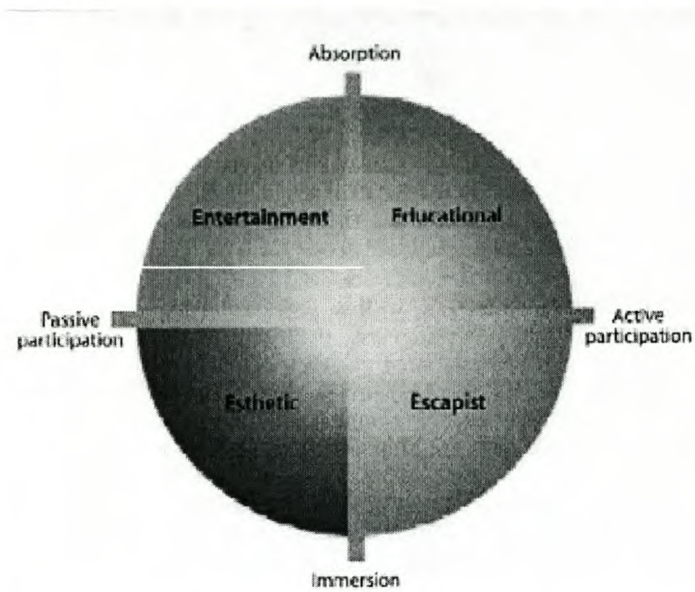
- Entertainment, for example takes place when going to the movies.

- Educational, involves active participation for example taking ski lessons.

- An Escapist experience involves a greater amount of participation from the customer and also immerses the customer in the experience. The example might be used of a person climbing down the Grand Canyon.

- In the last realm, called Esthetic, the customer is not actively involved in the experience, but is still immersed, for example a tourist in an art gallery.

Figure 3.2: The four realms of an experience



Source: Pine and Gilmore, 1998

When designing the experience according to the related realm, Pine II and Gilmore provide five experience design principles that can be applied in the experience design process:

- To theme the experience

Caesar's Palace Casino, Hard Rock Café and Planet Hollywood all conjure up memories or images of an experience. A theme therefore facilitates the building of impressions and storing of memories and should be the centre around which the elements of the experience turn.

- Harmonise impressions with positive cues

Cues should be used to create impressions with customers so that memories of the expression can be built and stored more effectively.

- Eliminate negative cues

While designing the experience negative cues should be eliminated so that the value of the experience is not diminished in any way.

- Mix in memorabilia

Goods representing the experience that occurred are valued much higher in price. A T-shirt bought at a Rolling Stones concert represents much greater value to the customer than a normal T-shirt does.

- Engage all five senses

The greater the number of senses involved in the experience, the greater is the enhanced effect of the experience and the more lasting the memories.

Haeckel, Carbone and Berry (2003) define the "total experience" as the feelings customers undergo when interacting with the goods, services and the "atmosphere" the firm emits. The experience consists of "clues" that are perceived by the customer and stored as rational and emotional impressions. Managing the customers experience involves the integration and presentation of a series of these clues to meet the customer's expectations. The 'clues' can be categorised into two parts:

- Clues can be of a functional nature. An example could be the bank ATM that is working correctly to convey the necessary information.

- Clues can also be of an emotional nature and leads to affective responses. Emotional clues can be divided into two types of clues namely mechanics and humanics. Mechanics involves clues emitted by things while humanics involves clues that are emitted by people.

Haeckel et al. (2003) have identified three principles that are important in creating value for customers in their experiences:

- The experience breadth should be combined with the experience depth. The breadth of the experience involves the sequence of experience stages the customer undergoes while interacting with the company. With the breadth it is important to understand that the experience of the customer starts even before physical interaction with the customer, such as the knowledge the customer receives from the information brochure even before the customer walks into the lobby. The depth of the experience is the amount of multi-sensory clues that combine to form an impression at a certain stage of the experience.

- Mechanics and humanics should be utilised correctly to improve the functional clues. Through the correct combination of the emotional clues the functional clues are better enhanced.

- Organizations should connect emotionally with their customers. Organizations who understand experience management, design clues to lead the customer towards a more positive customer experience.

To find the correct combination of all the clues Haeckel et al. (2003) recommends the use of an experience audit to analyse the customer experience. This audit can be done through the use of Videotapes, digital photographs, in-depth interviews or narratives that describe the customer's experience. From the experience audit an experience motif is developed. The experience motif then becomes the foundation around which to integrate all elements of the experience.

Haeckel (2003) provides the example of a financial institution that had the motif of making the customer feel "recognised, reassured and engaged". Only clues that fit into this motif were accepted as part of the design experience. Another example is provided of a bank that wanted its customers to have a feeing of "psychological comfort". To accomplish this aim the bank had to redesign its entrance by removing the video surveillance messages and instead replacing it with a welcome sign. The tellers were also trained to make customers feel comfortable before conducting transactions with them.

"Non-monetary burdens can outweigh the customer's consideration of the price (Haeckel, et al., 2002)." Companies who do not regard the customers experience and focus seriously and only lower costs might actually decrease the value of the customer offering. Not only should the product and service functionality be managed but increased consideration should in addition be provided for the emotional experience of the customer.

3.4 Creating a customer experience in the financial services industry: The example of Commerce Bank

Commerce Bank in America has opted to delivering a customer-orientated banking experience based on principles utilised in the fast food industry. Their approach revolves around adding fun to the experience of the customer when going to the bank. Employees further enhance the experience by functioning as greeters in the bank to thereby make the customer feel welcome in every branch they visit. The bank has also decided to stay open at later hours so that customers can access the branch at a time more convenient for them.

The customer experience also includes free lollipops and balloons that are used as staples. When opening a new branch Commerce Bank involves the whole community through featuring comedians, acrobats and even massages. These special events continue to take place at the branch at least once a month. Commerce Bank has been doing exceptionally well in the past few years, opening 35 new branches in 2003, when other banks have been closing branches. It has also been successfully bringing a large amount of people to its branches and in the past ten years its stock price has increased at a higher rate than that of Microsoft's (Morgan and Rao, 2003).

3.5 The progression of managerial theory regarding the customer experience

3.5.1 The customer experience: A subcomponent of customer relationship management

According to a recent Gartner (Kirkby et al., 2003) report, CEM is regarded as part of CRM and compliments the building of brand awareness. The brand builds a promise and CEM is viewed as the realisation of the promise in the value that is delivered to the customer. The brand is no longer only built though mass media but is built through every interaction the customer has with the organization by means of the organization's touch points. Touch points are the different areas through which the organization and the customer meet. Every organization provides an experience and these experiences determine the future behaviour of the customer.

It is therefore important for organizations to increasingly design and manage the experience. The experience the customer undergoes builds loyalty and forms the relationship between the customer and the organization. The customer experience should therefore be designed around expectations customers have, then consistently delivered across all the channels of the organization and managed throughout the organization by feedback from the customer.

Kirby et al. (2003) view the management of CEM as consisting of two parts:

- "The Strategic Design
- Continuous Improvement"

Customer feedback and the organization's reaction to this feedback have relevance to both these parts. Organizations need to exceed customer expectations at the touch points that are most important to the customer and meet the customer expectations at the other touch point.

Kiska (2002) argues that CEM is an addition to CRM. CRM captures purchase information from the customer and provides a historical perspective of the customer. With CEM a 360-degree view of the customer is needed across all organizational functions. Kiska identifies the need in CEM for customer feedback and the integration of this feedback into the research and development lifecycle. By utilising feedback from the customer, the risk of meeting market needs is reduced. Through the combination of CRM and CEM data, involving historical purchasing data, customer expectations and customer satisfaction information, the sales and marketing department can more effectively design market strategies and identify market trends.

Gutek et al. (2002) have criticized organizations for viewing the interaction between complete strangers in a business context as a service relationship. Instead these relationships are deemed pseudo – relationships, because organizations act like they have a relationship with the customer but the person providing the service and the customer are in fact strangers and have had no regular previous interaction. In a pseudo – relationship organizations therefore create a false sense of personal relationship while interacting as complete strangers.

The service experience can be enhanced when organizations understand the difference between service relationships and service encounters. An example of a service relationship is a relationship with a personal hairdresser or physician, while an encounter in comparison can occur between the flight attendant and the customer who do not intend to see each other again in the future. In a service relationship the provider of the service has had repeated interactions with the customer and therefore can claim to have a relationship with the customer. A service encounter in comparison is viewed as a single interaction between a customer and the provider of the service. The provider of the service in this regard is different from the organization, in that providers are employees working for the organization.

Understanding the difference between an encounter and a relationship interaction can assist an organization in deciding on the correct strategy, structure and marketing to apply. Both relationship and encounter businesses have distinct advantages and disadvantages to consider and deciding between the two businesses is a strategic choice managers would have to make by considering the needs of their customers.

3.5.2 The customer experience: As organizational strategy

Mitchell (2001) argues that organizations should view value from the point of view of the customer's experience and not by looking at what new advantages the organization's products and services currently have. By understanding the perspective of the customer, organizations can become buyer centric rather than sales centric. This can occur through mechanisms such as communities of interest in which the organization becomes involved in the interest customers show in experiences. Kirby et al. (2003) has found that in order for a company to manage the customer experience correctly, a customer centric view is needed together with a strategy that aligns the organizational culture throughout the organization to enable collaboration in the delivery of this experience. By correctly managing the customer experience organizations can expect:

- Improvement in customer retention over the short term.

- Growth in customer loyalty over the long term.

- To create a competitive advantage.

In the demand driven economy brands are becoming less distinct than they used to be. To differentiate between brands the need arises to create a personalised customer experience through the various touch points of the organization.

To effectively manage the customer experience organizations need to cooperate across the organization. The customer experience needs to be lead from the top and staff should be trained in the right skills to deliver a custom made offering. Gartner Research (Kirby, 2003) emphasises the importance of knowledge management in the interaction process and the need learn from this interaction.

In designing the structure of the organization around the different segments, it is important to correctly distribute the resources according to the targeted segments. In this way more support can be provided to more profitable customers.

Wheeler (2003) argues that the customer experience has increased in importance and has now become a strategic priority. CEM concentrates on understanding the aspirations of customers through their brand usage and views the customer's service experience in the context of the customer lifestyle. Wheeler emphasises that when organizations deliver a branded customer experience, customer loyalty is built that leads to long-term profitability.

Customer experience management (CEM) further involves an understanding of what customers expect from suppliers. This can be done through the advantages offered by technology whereby organizations can better capture the "customer's voice" and form a singular customer focus.

3.5.3 The customer experience: Empowering customers through choice

Research done by CGE&Y (Bessellieu et al., 2001) has found that creating a customer experience requires more than the pursuit of traditional CRM. Current efforts should therefore exceed merely building databases to target customers for marketing purposes. It can also not be simplified to defining the life needs of a customer and selling them one product to meet these needs. CGE&Y suggests viewing the whole experience from the perspective of the customer and offering them a spectrum of choices to meet their needs.

Companies selling home loans need to sell more than traditional mortgages, they also need to look at the desire of customers to establish a home, which includes finding schools, shopping centres and other needs involved with running a household. Wyner (2003) also recognises that many companies may wish to address a spectrum of customer needs, but after accessing the whole lifetime of a customer, many companies only offer them one product that has traditionally been the centre of the company.

Prahalad and Ramaswamy (2003) argue that because of the increasing similarity of products, organizations are striving to increase market space by offering a greater product variety. Through this product variety customers can choose the best products to satisfy the needs of their current situation. The problem with such a great product variety is that it can lead to confusion with customers and make their choices more complicated. A decrease in the customer value of the experience could follow.

Sievewright et al. (2003) specify that the innovativeness of financial service industry products can be grouped into Parameterized products and Integrated Relationship Products:

- Parameterized products consist of features, performance and pricing that can be changed to create value for the market segment at which it is directed. These products can be either customized to a market segment or can be individually customized. When differentiating on an innovation spectrum, the individually customized product is viewed as more innovative than the market segmented product.

- Integrated relationship products refer to various products that are combined to create cost or efficiency benefit for the customer or the supplier. Here the innovation spectrum shifts thorough three stages. The first less innovative stage is a traditional product such as the combined loan account. The next shift of innovativeness is a combination of banking products and the furthest step in the innovation spectrum would be a broader range of financial services products, which could include insurance and brokerage products.

3.5.4 The customer experience: Interactive value creation process

Pine II and Gilmore (2000) suggest that users differ in the combination of goods and services they want and attributes they need. Every standardized product or service has features that the customer must take, even if they do not want them. The customer therefore learns that the organization does not cater for his or her individual needs in the offering the organization presents to the customer.

At every interaction between the organization and the company, learning occurs. Over a period of time one of the parties changes their behaviour to adapt to the circumstances. In many cases the party that adapts and changes behaviour is the customer. The customer might stop asking for something that they truly want or in other circumstances they may decide to discontinue the relationship.

In Selnes and Sallis's analysis of relationship learning they have defined relational learning as "a joint activity in which the two parts strive to create more value together, than they would individually or with other partners (Selnes and Sallis, 2003: 81)." The purpose of a relationship is understood as the connection between the buying activities of the customer and the selling activities of the company. If both the buyer and seller are satisfied with the relationship's effectiveness and efficiency, then the relationship can be deemed successful. Selnes and Sallis (2003) have found that relationship learning can enhance the performance of the relationship but simultaneously greater levels of trust can inhibit learning in the relationship.

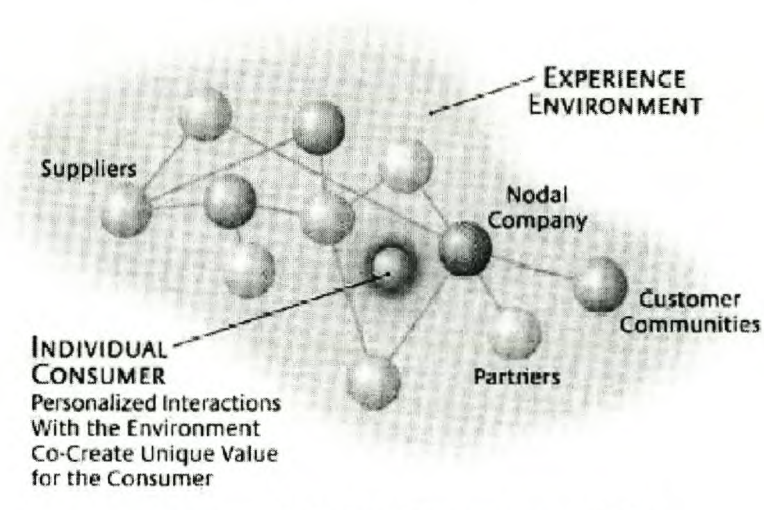
Prahalad and Ramaswamy (2003) have argued that the need has arisen for customers to interact with the company in "co-constructing" their own consumption experience to thereby "co-create" value. Not only are technologies and industries converging as seen in the financial services industry, but customers are also becoming more informed, connected and actively involved with companies. This implies that a product centric view of innovation is no longer enough and the need arises for organizations to involve the customer in "co-creating" value through experiences.

Prahalad and Ramaswamy introduce the concept of the 'Experience space' in which the locus of innovation shifts to the customer and the individual consumer becomes central to the event. In the experience space, the personal meaning derived from interaction and co-creation is what creates value for the consumer.

The experience space falls within the greater realm of the experience environment, which is supported by the experience network of the organization. Prahalad and Ramaswamy (2003) define the experience environment (Fig 3.4) as the combination of the customer's interaction and the organizational network's capabilities, which meet the context and time specific needs of the customer.

Prahalad and Ramaswamy argue that the desired experiences of customers cannot be determined beforehand and the involvement of customers and customer communities is required to create a variety of customer interactions able to satisfy the needs of the customer in a given context and time.

Fig 3.3: The customer within the experience environment



Source: Prahalad and Ramaswamy, 2003

Numerous organizations have already made the shift from providing products to providing solutions for customers, but few organizations have started to implement the change from providing solutions to interacting with the customer to create a differentiated experience.

3.6 Summary

Chapter III analysed the concept and dynamics of the total customer experience. This Chapter explains how economic value has progressed from the product level through to the service level, and has come to focus on creating value in customer experiences.

The author of the study indicates how the customer's experience can be analysed in various dimensions. These dimensions range from the level of participation the customer has in the experience, through to the relationship between the customer and the experience. The differences in the dimensions are illustrated by the use of a model that explains the different realms in which an experience can occur.

The customer experience can also be analysed according to rational and emotional clues that are stored in the mind of the customer when interacting with the organization. To thoroughly analyse the customer experience, an experience audit is suggested whereby the organization can understand which experience motif it seeks to develop and deliver to the customer.

The example of Commerce Bank of America is provided to illustrate how a commercial bank adds fun to the experience of the customer and how the bank has achieved success in providing customers with this experience.

Until recently CEM has been viewed from a CRM perspective. A negative aspect of viewing CEM as a subcomponent of CRM is that this might lead to the analysis of the customer experience through use of historical transactional data. Combining CEM data and CRM data could more effectively provide a 360-degree view of the customer, but in applying this data the customer remains a passive participant in his own experience.

Other authors have argued that organizations should decide between creating relationships and creating encounters. Both these strategies have negative and positive aspects and organizations would benefit from understanding of the interaction that the customer desires. Organizations that understand the difference between a relationship and an encounter can accordingly adapt their strategy, structure and marketing efforts to more effectively accommodate the customer.

Currently managerial attention increasingly perceives the need for the organization as a whole to be aligned in the creation of the customer experience. This perception creates a shift in viewing the customer experience as a CRM subcategory to being viewed as a strategic priority.

The shift in perceiving the customer experience as a subcomponent of CRM to perceiving the customer experience as a strategic priority also constitutes a shift in emphasis from conceptualising the customer experience as a variety of choices to conceptualising the customer experience as an interactive value creation process between the organizational network and the customer. In this interaction process, learning occurs between the organization and the customer whereby value is created for both the customer and the organization. This interaction process thereby enables the customer to become the co-creator of his own experience within the experience environment of the organization.

PART TWO: INNOVATION THEORY AND THE NECESSITY FOR CONNECTIVITY ACROSS ORGANIZATIONAL BOUNDARIES

Chapter IV

A review of Extant Theory regarding Innovation Management

4.1 Introduction

This chapter seeks to systematically review extant theories relating to innovation management through which the reader can develop an understanding for the strategic necessity of interaction throughout the innovation process. The main theory classification in this chapter is based on Sundbo's (1999) research on the theories of innovation. Sundbo's innovation classification according to the basic entrepreneurial theory, the technology-economics theory and the strategic theory is used as background to introduce the reader to the more recently developed concepts of radical and incremental innovation.

The chapter finds conclusion in Complexity theory that seeks to bring a unique perspective to the seemingly divergent views of radical and incremental innovation, suggesting that organizations seeking to increase long-term profitability should function on the edge of chaos by dynamically interacting with the organizational environment.

The purpose of chapter IV is to familiarise the reader with innovation theory and serve as a conceptual aid through which to interpret the subsequent chapters relating to innovation and the necessity for interaction in the innovation process.

4.2 Defining innovation

When defining innovation Tuomi (2002) differentiates between the inventor and innovator by stating that, an inventor makes an effort in solving problems creatively while an innovator refines these inventions and changes them into products ready to be used. This agrees with Schumpeter, who viewed an invention only as an innovation when it is productively applied and a new function of production is created (McDaniel, 2000).

Sundbo (1999) classifies innovation in terms of Schumpeter's definition into the following types of innovation:

- A new product or service
- A new production process
- A new organizational or management structure
- A new type of marketing or behaviour impacting the market, which includes relationships with various external role-players such as government, societal organizations and customers.

Innovations also have characteristics such as:

- Technological
- Intellectual
- Physical movement
- Behaviour – such as a new business model or organizational structure.
  (Sundbo, 1999)

4.3 Innovation theories

Sundbo (1999) identifies and explains three theories of innovation: 1) The Basic Entrepreneurial Theory, 2) The Technology – Economics Theory and 3) The Basic Strategic Theory.

4.3.1 The basic entrepreneurial theory

The entrepreneurial theory of innovation emphasises the entrepreneur as a strong internally driven individual, and places importance on psychological factors within the entrepreneur that leads the entrepreneur to innovative behaviour. The endeavour of applying new ideas and means of production was viewed by Schumpeter (McDaniel, 2000) as innovation and was a function that was carried out by entrepreneurs.

Drucker (1985) agrees that innovation is the specific function of the entrepreneur and is the method by which an entrepreneur creates new resources that produces wealth, or adds enhanced potential to existing resources. Drucker views innovation as following from a continuous searching process that originates from four sources internal to the company namely, unexpected occurrences, incongruities, process needs and industry and market changes, and three sources external to the company namely demographic changes, changes in perception and new knowledge.

4.3.2 The technology – economics theory

With the Technology – Economics theory, technological development is the focus with the emphasis mainly on product innovation and process innovation. Both push and pull factors are considered in this theory, but pull factors have only recently increased in importance with special consideration of the role of the customer in innovation (Thomke and Von Hippel, 2002).

In this theory the Research and Development department has been the central consideration, including the role of cross functional groups and the function of network-oriented behaviour. The increasing focus on networking behaviour with the world outside the organization has in turn led to the consideration of strategy as a source of innovation. (Sundbo, 1999)

4.3.3 The basic strategic theory

Sundbo (1999) describes the third developmental stage of the theory of innovation as the basic strategic theory. This theory regards innovation as the organizational change and technological development in an organization in relation to change in the market environment. The theoretical development of the strategic theory of innovation builds on the resource-based view of the organization, which explains competitive advantage as the correct combination of an organization's resources.

4.3.3.1 Core competencies

Hamel and Prahalad (see Sundbo, 1999) introduce the concept of core competencies, which are skills and technologies the organization utilizes to create a competitive advantage when creating new products. This theory emphasises the need for the organization to be involved in a constant development of competencies in order to remain competitive. Hamel and Prahalad (1994) have argued that organizations need to perceive in which direction the industry is moving and how they can best capture value in this direction. Organizations are then required to set out to develop competencies to transform the industry in the direction they have perceived, instead of waiting until the organization enters a crisis that necessitates the creation of the required competencies.

4.3.3.2 Developing dynamic capabilities

In line with the resource based view of the firm Teece et al. (2000) have argued that obtaining a competitive advantage should be done by developing dynamic capabilities. These authors argue that the 'competitive forces' theory, which emphasise the positioning of a firm in regards to its competition and the trading of assets to strengthen this position, faces certain obstacles. The main obstacle concerns the problematic nature of assets, in that they are not as easily transferable, developed or tradable as implied by the 'competitive forces' theory.

Tushman and Anderson (1998) argue that core competencies that led to success in the past can trap an organizations in its past and lead to failure of the organization in the future. Thus core competencies can become core rigidities over a period of time. Contingency theory has suggested that in order for organizations to perform competitively a dynamic fit between internal organizational design variables and external environmental variables is needed. (Aragôn-Correa and Sharma, 2003)

In accordance with contingency theory, dynamic capabilities create competitive advantage through the management of scarce resources such as the acquisition of new skills, managing intangible assets and implementing learning for strategic change. The emphasis therefore shifts to a continuous change in the competencies of the organization to accommodate the change in the external environment (Teece et al., 2000).

4.3.3.3 Radical and incremental innovation

Nonaka (1995) indicates that strategy has come to concentrate on the behavioural aspects of the company and has changed from emphasizing where a company will compete to how a company will compete. The two different strategic approaches can be analysed from Von Krogh et al. (see Nonaka, 2000) suggestion that there are essentially two types of strategies: survival strategies and advancement strategies.

"Survival strategies secure current strengths of the company", it "emphasizes current strengths and minimises current weaknesses." Advancement strategies in contrast focus on securing future profitability, "their aim is to take advantage of future business opportunities and neutralize future threats in the environment (Nonaka, 2000, 71 – 73)".

Recently emphasis has been placed on the difference between radical (disruptive) and incremental (sustaining) innovation (Tushman and Anderson, 1997; Hamel, 2000; Christensen and Overdorf, 2000; Govindarajan and Gupta, 2001). Radical innovation is defined as competence destroying innovation where the current method of doing things is changed, where as incremental innovation is seen as competence enhancing innovation where improvements are made on a regular basis.

Christensen and Raynor (2003) further indicate that disruptive innovation is a relative term and that if the business idea is viewed as disruptive but is rather sustainable to other businesses, the organizations pursuing the innovation opportunity might find an unexpected increase in competition. These authors argue that there are two types of disruptive innovation. The first type of disruption is viewed as a low-end disruption which leads to a lower cost business model addressing currently served customers. The other type of disruption is a new market disruption which creates a new value network and is aimed at a new way of consumption that has previously not been addressed.

Christensen, Raynor and Anthony (2003) indicate to the 'innovators dilemma' which occurs when companies do everything right and other companies take their customers away by creating new markets. Established organizations move along a traditional performance trajectory while disruptive innovations create a new performance trajectory. Disruptive innovations need to go through a developmental cycle before they can become profitable for the company and acceptable for the mainstream consumer. For this reason established organizations rather opt for short-term successes and incremental innovation and have problems with long-term sustainability when disruptive innovations become profitable.

In the past the difference between incremental and radical innovation was only analyzed in technological context (Sundbo, 1999), but currently radical innovation has become increasingly important in the determination of the behaviour of the organization (Hamel, 2000; Govindarajan and Gupta, 2001).

Hamel (2000) argues that the key competitive advantage of organizations in the current economy reside in non-linear innovation. This implies innovation that changes the business model of the firm and impacts on the transformation of the industry. Hamel indicates that innovation should be analysed in the context of the whole business system and not just as product innovation or innovation of the business processes. Kim and Mauborgne (1999) agree with this argument by suggesting that firms should not concentrate on outperforming their competitors but should instead focus on value innovation that stimulates the demand side of the economy and causes competitors to become irrelevant.

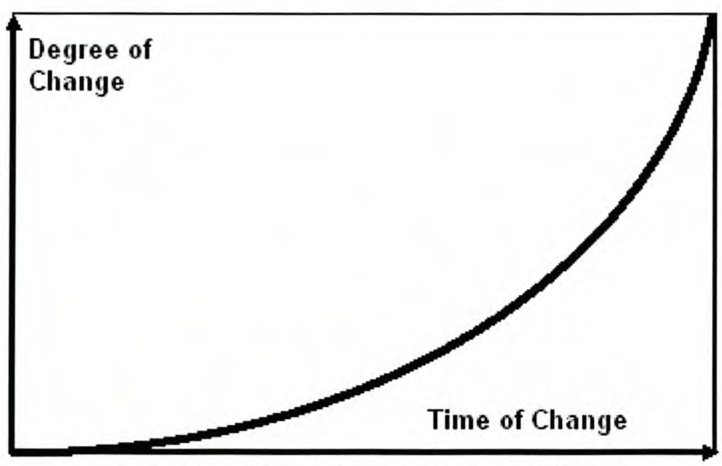
Tushman and Anderson (1997, 15) have introduced the concept of ambidextrous organizations that seek to create incremental and discontinuous innovation simultaneously. They argue that a balance should be achieved between the needs of today and that which is possible in the future. Entrenched units that manage for incremental innovation and ensure current profits for the organization are in conflict with units that pursue discontinuous innovation and are the sources of success of the organization in the future. Top management is therefore required to manage different units of the organization that ensue conflicting interests.

Nonaka (2000) agrees with Tushman and Anderson in that a balance should be kept between survival strategies and advancement strategies. This balance would lead to preparation of the organization for disruptive change such as "vanishing industry boundaries, rapid transition of the industry, the rapid devaluing of the existing knowledge and competencies and the obsolescence of existing products and services (Nonaka, 2000, 73)." Both survival and advancement strategies are therefore important for building and sustaining competitive advantage and demand equal attention from managers.

4.4 Complexity theory

The exponential increase in change in the environment (Mumme, 2003: Fig 4.1) has led management researchers to utilise complexity theory in gaining insight into organizational dynamics and market tendencies. Complexity theory differentiates between detailed complexity and dynamic complexity. Detailed complexity consists of a static pattern of linear relationships between the elements of a system while dynamic complexity refers to non-linear interaction between the elements of an open system. Dynamic complexity explains the increased amount of disequilibria and change in systems as the result of the actions of various entrepreneurs.

Fig 4.1: Exponential development of change



Source: Adapted from Mumme, 2003, 3

Dynamic complexity functions on a scale between a stable state and a chaotic state. In the stable state the system is predictable, but only for a short time before it reverts to a state of chaos. The time between stability and chaos is referred to as "the edge of chaos (Black and Farais, 2000)".

Pascali (1999) refers to this dynamic complexity as a complex adaptive system and argues that patterns in this system can be recognised and be applied to understand future developments. Kurtyka (1999) makes special reference to bankers by stating that complexity facilitates bankers to view their industry from a different perspective and thereby provide them with new insight into their industry.

Beinhocker (1997) provides three characteristics of open adaptive systems.

- The systems are open and dynamic, creating an energy flow from the organization to external sources and also from external sources to the organization, resulting in disequilibria, which continuously shifts the systems behavioural patterns.

- Interacting agents create various relationships with other agents that continuously evolve the strategies of the organization to transform it into a complex adaptive system.

- The complex adaptive system displays self-organization. This occurs when various agents in an open system dynamically interact to influence the structure from the bottom-up. This bottom-up approach follows from self-organization between the various agents and is the opposite of a top-down approach where control is enforced on the organization.

Organizations need to operate on the edge of chaos, also called generative complexity, in order not to become rigid or otherwise revert to chaos (Pascali, 1999). Operating on the edge of chaos leads to a high degree of creativity, but depends on the ability of the organization to self – organise. To set the environment for self-organization to occur, managers need to enable three categories of activities:

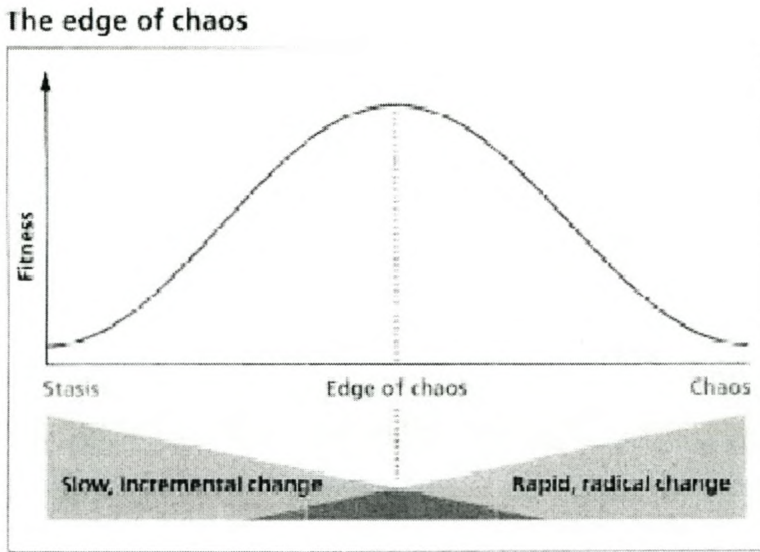
- The organization needs to firstly establish the context in which self-organization occurs. This is done by creating a shared vision within the organization which is aligned with the strategy of the organization and which flows from the culture of the organization.

- Managers need to disturb the system to enable continuous creativity. This can be done through involving diverse opinions, enabling rich information flow and creating goals for employees to strive towards.

- Lastly the organization needs to be cultivated to foster and build relationships. Shared organizational success needs to be communicated through leadership and learning needs to be developed within the organization. (Youngblood, 1997)

Beinhocker (1997) explains that at the edge of chaos organizations function both conservatively and radically by exhibiting a high degree of fitness. Fitness is developed through the evolution that takes place by keeping normal processes operational and simultaneously experimenting radically. Figure 3.2 provides and illustration of how the edge of chaos can be viewed.

Fig 4.2: The edge of chaos



Source: Beinhocker, 1997, 35

4.5 Summary

This chapter commenced by defining innovation theory and analysing the underlying assumptions to the theories. It then built on the basic strategic theory of innovation to understand current managerial thinking regarding innovation.

The basic entrepreneurial theory concentrates on the role of the entrepreneur in the economy and how entrepreneurs utilise innovation as the tool to produce new products and services. In this theory the entrepreneur is viewed as the person involved in searching for the correct resources and then implementing these resources to create new resources.

The technology–economics theory regards innovation as a deterministic process of technological push- and pull-factors on products and processes. Through this perspective innovation can thus be viewed as deterministic in nature and dependant on certain demand factors in the environment. The theory also emphasises the role of the Research and Development department in the innovation life cycle. Within this school of thinking the open source movement and the need for network relationships have gained increasing attention, which has led managerial theorists to recognise the need for a strategic analysis in innovation theories.

The strategic theory to innovation evolved from the recognition of innovation as the result of the correct allocation of a firm's resources. Understanding the value of the implementation of the correct resources then led management thinkers to regard these resources as the core competencies of an organization.

The dilemma experienced with core competencies is that in a changing environment these competencies can inhibit an organization's performance and become core rigidities, leading firms to compete with competencies based on past performance. By also recognising contingency theory as the need for the organization to adapt to its environment, the emphasis thereby shifted to the need for organizations to develop intangible resources that are of a dynamic nature. In line with this argumentation it has been suggested that organizations need to develop dynamic capabilities such as learning and knowledge management to fit the organization with the external environment.

The continuous development of organizational resources led managerial theorists to increasingly consider behavioural strategies. Concentrating on how to compete, therefore behavioural aspects, led organizations to create new markets by radically innovating the way in which they currently compete. This does not imply that incremental innovation, which seeks to strengthen current business operations, should be disregarded, but instead it should be considered as an important aspect for the continuous survival of an organization over the short term.

Complexity science has recently led to new perspectives on the implementation of strategy or strategies and how the organization should be managed to create and apply these strategies. From the perspective of complexity theory the organization can be conceptualised as an open adaptive system that interacts dynamically with its external environment. This open adaptive system needs to function on the edge of chaos to keep from becoming too controlled and stagnate into bureaucracy, or become too uncontrolled and lead to chaos. Complexity theory seeks to bridge the gap between radical and incremental innovation suggesting that management can create the correct context for an organization to develop the necessary fitness and thereby evolve the appropriate strategy for the current environment.

Chapter V

Innovating the Customer Experience:

Leveraging Customer Knowledge Management for Continuous Innovation

5.1 Introduction

Chapter V critically analyses various styles and methods of how customer innovation can be implemented and utilised to add value in sustaining innovation activities. The chapter emphasises the need for external knowledge management in the interaction between the customer and the organisation in the process of innovation and provides examples of how customer innovation can be and has been utilised in the financial services industry and other industries.

Knowledge Management has been defined as "the systematic management of the knowledge process by which knowledge is created, identified, shared and applied to improve a company's performance (Dore, 2001, 23)". Leibold et al. additionally defines knowledge by differentiating between Data, Information, Knowledge and Wisdom. "Data is elements of analysis. Information is data with context. Knowledge is information with meaning. Wisdom is knowledge plus insight and sound judgment (Leibold et al., 2002, 14)."

Knowledge is regarded the new source of value in the current economy and is described as the ability of groups to collectively solve problems and identify areas for new business development through learning from each other (Leibold et al., 2002).

5.2 Knowledge management and the necessity for customer involvement

In the current knowledge economy importance should not only be given to explicit knowledge residing in documents and processes, but also to tacit knowledge which resides in peoples heads and cannot easily be transferred or expressed. Through converting tacit knowledge into explicit knowledge, and leveraging this knowledge through interpretation and analysis, value is created.

Dore (2002) explains that knowledge management consists of both internal and external approaches. The internal approaches concern the strengthening of relationships with employees and motivating them to share knowledge through recognition and reward. The external approaches comprise of customer facing knowledge management, which consists of building relationships with customers and enhancing the flow of knowledge from the customer back into the development of products and services. Sievewright et al. (2003) has further suggested that the search for innovation commences with the collection and utilisation of customer knowledge.

According to a 2001 survey (Dore, 2001) of the European top 200 banks and 100 insurance companies, knowledge management is still at a relatively young stage in the financial services industry. Only 33% of organizations in this survey have implemented a knowledge management program. In the survey insurance companies seem to be more aware of the benefits of knowledge management than banks.

Both banks and insurance organizations have declared customers to be the most important source of information. In the survey carried out by Dore (2001) 66% of banks have rated the customer as the most important source of information while in the insurance industry 80% of insurance organizations have rated customer information as the main source of information.

In the knowledge economy changes in technology will lead to ever increasing interconnectivity between people and organizations, with organizations extending themselves into multiple relationships of organizations and individuals. The creation of new knowledge is therefore increasingly being generated from external sources and innovation is occurring at the "interfaces between firms and the market, regulatory and institutional environments, within which a firm operates (Dore, 2002, 12)".

Schmitt (2003) explains that there is a need for dynamic exchanges through interaction with the customer that enriches not only a products feel and touch but also a products image. This interaction leads to continuous innovation that should also influence the interface between the customer and the organization.

5.3 Analysing knowledge flows between the customer and the organisation

Gibbert et al. (2002) indicate that there is a difference between knowledge about the customer and knowledge from the customer. Knowledge about the customers resides in CRM databases while knowledge from customers empowers the customer as a knowledge partner of the organization. Companies are increasingly realising that the customer possess valuable knowledge and that this knowledge can be gained through direct interaction with the customer.

Most knowledge programs typically share knowledge regarding the customer or what others thought of the customer, internally to the organization. Gibbert et al. (2002) argue that the competencies of organizations have shifted past the corporate boundaries and now also require the need to include the knowledge residing with customers.

Gebert et al. (2002) have classified knowledge flows of CRM into three categories:

- Knowledge from customers

This consists of knowledge customers have regarding products, suppliers and markets. The knowledge that flows from interaction with customers assists the organization in continuous improvements.

- Knowledge for customers

This knowledge is required to satisfy the knowledge needs of customers. To match customers with products and services, customers need to have the knowledge of these products and even information of markets and suppliers.

- Knowledge about customers

To understand customer purchase motivation and the requirements of customers there is the need for knowledge about customers. This knowledge includes "customer histories, connections, requirements, expectations and purchasing activity (Gebert et al., 2002)".

5.3.1 Utilising knowledge flows from customers in innovation management

Gibbert et al. (2002) have found that companies can utilize the knowledge of their customers to create value. The South African insurance company Old Mutual asks customers to fill out their own medical insurance form electronically. Medical examinations is still required, but by sharing their knowledge policyholders enable more accurate knowledge transfer, greater knowledge transfer and faster service. The company can also utilise the information to create and develop new products.

5.3.1.1 Five styles of customer knowledge management

Gibbert et al. (2002) categorise and describe five styles of customer knowledge management (CKM):

- Prosumerism

  The emphasis here is on the role of the customer as both producer and customer. The customer therefore acts as co-producer. An example in banks is the use of ATM's that enable customers to co-produce the service of placing deposits, withdrawing money or checking his account balance.

  With regards to knowledge management this style enables the customer to learn more about available options, which then enables the customer to make better-informed choices and assist in the creation of tailor made offerings. This approach is utilised by the financial services program Quiken, which enables the customer to learn about the resources in the financial services industry, while at the same time suggesting new ideas and benefits, and then utilising this learning to create better future offerings tailor made to the customer's needs.

- Team-based co-learning

  With this approach the focus is not as much on producing products and services but rather on enabling learning interaction whereby customers can learn from one another. The organization's role is therefore in structuring resources so that this learning interaction can occur. In order to structure the resources correctly the organization needs to learn from the interaction of the customers. An example of this interaction platform is Amazon.com that links various companies and customers with one another and enables customers to learn from one other through methods such as book reviews.

- Mutual innovation

  This approach takes place through collaborating with end-users in innovating new products and services. Leibold et al. argues that too much concentration on acquiring information about customer needs might lead to incremental innovation, but to enable breakthrough innovation closer interaction between the organization and its customers is needed.

- Communities of creation

  Communities of creation are groups that interact across organizational boundaries to combine their knowledge in creating new products and services. This is currently done virtually through new chat rooms or chat groups where customers can interact and learn from one another's experiences or through the use of "beta" products that customers use and test for companies such as Microsoft.

- Joint intellectual property

  Leibold et al. emphasise the high degree of involvement between the customers and the company in this style. The example of the Swedish company Skandia Insurance is provided to illustrate how knowledge is jointly owned by the customer and the company, not only to create new products and services but also in creating new lines of business. Skandia collaborates in reviews with its retail customers, brokers and banks along with important decision makers in the company to decide on strategies to follow in joint business development.

5.3.1.2 Communities of creation

Sawhney and Prandelli (2000) propose an innovation management mechanism namely the "community of creation". This community has permeable boundaries that lie between a closed hierarchy and a fully open market based model. The community socialises through a common experience which might be best understood through Nonaka's concept of 'ba'. Ba indicates to a shared space where knowledge is openly shared and altered. Through contribution and exchange of knowledge, the knowledge that is held therefore becomes greater than the sum of the knowledge residing in every participating individual.

Sawhney and Prandelli (2000) have indicated to a shift in the locus of innovation from within the firm to sources external to the firm, residing in a community. The authors suggest that there are certain factors that are currently changing the business landscape. The first of these factors is that advances in information technology make knowledge sharing increasingly easy through the greater interaction opportunities it enables. A second factor is that greater knowledge leads to a reduction in uncertainty. Sawhney and Prandelli argue that when knowledge is shared, value is added to this knowledge, which supposes that social interaction leads to greater knowledge sharing, which culminates in value creation.

Sawhney and Prandelli (2000) provide three models that can be applied for the organization of innovation.

- The hierarchy model is a closed model. In this model knowledge is mostly shared within the organization and control is centralised. An example of this model is Xerox, which sponsors venture capital firms by bringing them into the boundaries of the organization. After a period of time the decision is made to integrate the venture capital firm into the company by making it a business unit of its own or selling the venture capital firm off to another firm if it does not fit with the overall strategy of the organization.

- The second model is that of a completely open market model. IBM utilises this model through the open source movement. In this model product development is enhanced through feedback in discussion forms in which researchers partake. In these discussion forums product managers submit their wish lists for new technological features to further develop their products. The company Alpha Works create a community environment in which users can partake and share knowledge to enhance the products.

  The advantages of this system are enhanced product development time and flexibility in schedules. The problems are that there is very loose control over the compatibility of products and the quality of products. There is also little control over the members of the community, which also influence the overall quality.

- The last proposed model is that of Sun's Jini project. This model balances the closed hierarchy innovation model with that of the "open market" model. This model functions as a "gated community" which supposes that membership is not open to the general public but only to those who have agreed to the terms and conditions of the projects and have signed the license agreement.

  Through the use of the license agreement intellectual property is kept within the community. The organizations that utilise these communities have to reward members for enhancements but can keep intellectual property on modifications within the boundaries of the organization. The firm does not set priorities on innovation but community members can set their own priorities. The community therefore shares knowledge within the community and members can decide if they want to participate within the community or develop on their own.

Swahney and Prandelli (2000) set out five key questions that managers need to ask themselves as the locus of innovation is shifting.

- What is the level of control that needs to be exercised?
- How should property rights be managed?
- What are the incentives that encourage participation?
- How can a community be evolved?
- Should a community only be virtual or can a community also function effectively in the physical realm?

The community of creation enables the firm to manage on the border of order and chaos functioning as a complex adaptive system. It allows the organization to be organic and open to the external environment and simultaneously to self – organise.

5.3.1.3 User toolkits

Von Hippel and Katz (2002) suggest enabling customer innovation through the use of toolkits. By making these toolkits available to customers, organizations can more effectively tap into customer innovation. In the past product development has mostly been driven from inside the company and traditionally the manufacturer needed to gather information about the customer before developing products. Organizations also normally find it relatively time consuming and expensive to determine customer needs. This makes the product development stage a long process of trail and error.

In this lengthy process the needs of the customer might have changed before the product reached the market and a customer might not become aware of a need till after he/she as tried the product. By designing toolkits for users the need-related development tasks, which reside with customers, can be transferred to the customer, while solution-related tasks are entrusted to the manufacturer (Von Hippel and Katz, 2002).

Customer innovation enhances traditional product development for two reasons. Firstly the company can receive customer innovation in relation to products more easily and cheaper. Secondly a customer can learn more easily about a product and that reduces the time of the trail and error process the customer when adapting to a new product.

Von Hippel and Katz (2002) note that designing user toolkits is not an easy process. Toolkits must enable customers to move through design cycles. Secondly they must have greater user friendliness and enable customers to rapidly learn a new design language. Thirdly they have to contain various design tools or models which can then be fit together so that customers can know the capabilities of the manufacturing company and the company that is able to produce the product.

In utilising toolkits certain benefits are achieved. Toolkits can satisfy subtle aspects of their customer needs, because customers have a better understanding of their own needs. Designs are completed faster because customers create them at their own location, following a process with a standardised toolkit can also speed up manufacturing time. Companies also have the ability to serve smaller customers, which would have been impossible to serve in the past because of the increased cost in services.

By implementing user toolkits the customisation of products is predominantly outsourced to the customer. The company produces and manufactures the product that customers design and therefore in the short term the customer is dependent on the organization to manufacture the product (Von Hippel and Katz, 2002).

Osterwalder, Pigneur and Lausanne (2003) have examined the use of toolkits in the business study of easyMoney.com. This example analyzed how users are enabled to create value for themselves and how this provides an organization with a competitive edge. Through an Internet portal tool called card-builder, users have the ability to combine their own individual preferences such as interest rate, service options, fees and cash back rewards in the credit card options they require. By creating their own product the user minimizes the risk of paying for options he/she does not need and thereby assists in creating value for themselves.

Von Hippel (2002) argues that companies would need to change their mindsets when the locus of innovation shifts from the organization to the customer. This would require the business model of the organization also having to undergo related changes.

5.3.1.4 Identifying lead users in the innovation process

In many situations organizations may struggle to find the customers with the needed knowledge to assist in building user toolkits or to involve in the innovation process. Lead users have been identified as customers who have a greater experience with certain products and a richer knowledge than other customers. These users have similar needs than other customers but recognise their own needs sooner than other customers do (Gurgul et al., 2001). They are also viewed as the users who benefit most from finding new solutions to current needs (Von Hippel and Riggs, 1996). Lead users are normally more involved with the use of the products than the general user and also make use of more of the features and advantages of the products (Gurgul et al., 2001).

Studies done by Von Hippel and Riggs (1996), regarding lead users in the Electronic Home Banking Services, have shown that customers value solutions proposed by lead users, more than current banking practices. Lead users are beneficial to the innovation process because they are the first to recognise a need and they have the best information regarding "real world experience (Michelman, 1996)". Utilising lead users in the innovation process was also found to be relatively cheaper than conventional methods of development.

Lead users can be identified through the questions that they ask and the support they request. Lead users are best identified in the interaction and interface between the customer and the company and therefore having a CRM system capable of capturing customer interaction data is important to their identification (Gurgul et al., 2001).

5.3.1.5 Understanding the customer's motivation to innovate

Von Hippel (2001) indicates that users are motivated to innovate when they think that the benefits of their innovations will outweigh their costs. Other incentives customers have to innovate include improved reputations, the ability to assist in building a community and the expectation of future reciprocity.

Gibbert et al. (2002) have argued that companies can encourage knowledge sharing behaviour through focusing on either the customer's intrinsic or extrinsic motivation. So far most companies have been focusing on the extrinsic needs of the customer by offering award programs for knowledge shared about the customer. Through effective utilisation of the Internet companies now have the ability to create interactivity between the company and the customer, and the customer is enabled to co-create and add value to the organization.

Von Krogh (2003) suggests that a mix between the extrinsic and intrinsic motivation is needed in order to stimulate innovation in the future. Factors such as enhanced reputation and a sense of community are perceived to be just as valuable when managing innovation as monetary based incentives are.

5.3.1.6 Customer innovation as source for continuous innovation

Avlonitis and Papastathopoulou (2001) indicate that studies done regarding the involvement of users in initial new product development cannot be generalised to retail products, because these studies apply to industrial markets and the products in these markets are developed to meet individual product needs. Retail products differ in that they are "off-the-shelf" offerings competing in a highly competitive market and because of this a much more extensive generation and screening process is needed to innovate a superior offering.

Ulwick (2002) argues that there are dangers to listening to customers too closely. One of the dangers is that instead of leading to radical innovation, customer innovation leads to incremental innovation. The reason for this is that customers only know what they have learned from experience and therefore most customers have a limited reference framework.

Christensen (1999) agrees that customers cannot be trusted to lead the company towards disruptive (radical) innovation opportunities. The functionality and usability of products that might currently be unsatisfactory to customers could become the radical innovation opportunity of tomorrow. Instead customers should be consulted for incremental innovation opportunities.

Leonard (2002) explains that the problem of "functional fixedness" causes customers to think in terms of how products and services have been used in the past. "Functional fixedness" therefore creates a limitation for customers to think in alternative ways. A second problem when involving customer in innovations is that customers might have seemingly conflicting needs. The apparently conflicting nature their needs makes it difficult for customers to suggest new ideas.

Schmitt (2003) emphasises that when structuring and designing the interface between the organization and the customer the most important input from users is behavioural in nature. Asking questions regarding what the customer wants to do in the branch or the website determines the needs the customer has when interacting with the organization.

5.3.2 Utilising knowledge flows about customers in innovation management

Ulwick (2002) warns that lead users can offer product ideas, but that because they are not average users, the solutions they recommend can be of limited use. Instead of concentrating on finding solutions from customers, organizations should focus attention on customer input that regards the outcomes of the processes. Ulwick describes a disciplined process that organizations can utilise to innovate. All the steps in the process are directed towards analysing the outcomes of the process. The steps therefore commence by identifying the outcomes and end with the creation of the products.

In the first step organizations should have interviews with a diverse group of customers and analyse the process or activities customers undergo when involved with the product or service. Secondly moderators should be attentive on capturing outcomes instead of writing down solutions. Thus comments made should be understood in the context of the outcomes. Thirdly outcomes should be organised into groups according to the steps the customers follow in the process. Fourthly when the outcomes are grouped they should once again be tested and ranked for relevance by making a quantitative survey. The results from this survey and data that has been accumulated should lastly be utilised to discover new innovation opportunities as well as create better market segmentation and assist in competitive analysis.

5.3.2.1 The argument for customer observation

Leonard (1997) argues that when no new product exists to compare existing products with, customers find it difficult to form an opinion of the new product. Observation is suggested as an alternative to getting suggestions from customers. Through observing the customer in his/her own environment researchers can understand what unspoken interactions and assumptions customers are making. By using five design techniques information can be gathered that conventional product research overlooks.

- Finding new information through triggers of use
  Understanding in which circumstances customers use products and in what way offerings are used can assist companies in discovering new innovation opportunities.

- Understanding interactions with the user environment
  Intuit uses a "Follow me home" program in which researchers are allowed to observe the experience of users at home when installing and setting up the personal finance-product Quicken for the first time. By doing this researchers can get an understanding into what programs Quicken interacts with and also what users use it for. Through the implementation of this program Intuit discovered how small business owners use their program to do bookkeeping.

- Gaining insight into how users customise products

  Understanding how users customise the organization's products provides organizations with the ability to adapt their products in order to meet these customised needs. A consulting company for instance observed that certain individuals combined cell phones and beepers to filter out unwanted calls.

- Discovering intangible attributes of offerings

  By observing how cleansing detergents are used researchers recognised that smell evokes valuable emotional reactions that are involved when using the product.

- Recognising unarticulated needs users have.

  Even though customers might not state or recognise their problems it might still be there. A product developer from HP observed surgeons using small cameras having problems looking on the screen with nurses walking around. Recognising this need the developer was therefore able to create a helmet, which enabled the surgeon to not get distracted from his work.

5.3.2.2 Utilising research and development (R&D) techniques: The Bank of America example

Thomke (2003) has analysed R&D tools for services by examining the techniques used by Bank of America. Most companies remain product centric in their development, but Bank of America is utilising disciplined R&D methods to improve their services. The bank recognised that the only way in differentiating itself from the competition was in moving away from traditional methods of delivering service.

To enable this objective the bank founded an Innovation and Development Team who is responsible for the development of products and services. The unit had to immediately discover new services and service delivery methods in order to strengthen relationships and decrease transactional costs. The bank made use of certain branches as testing facilities. Five banks were outfitted as "express centres" to enable high speed transactions while five other branches were used as "financial centres" where more sophisticated services were used by customers and the surroundings enabled a more relaxed atmosphere.

A prototype bank branch was also created to rehearse ideas before they were implemented in practice. Cameras were used at the test branches to capture the responses of customers to the experiments.

Control branches and repetitive tests were used to test the validity of the experiments and the processes and outcomes of the experiments were closely measured. The Innovation & Development team made repetitive tests in the same branches to filter out other variables and tested the same experiences in different branches to find out if relating factors were branch specific or not.

Fiscal discipline was carried out through banks having to fund the experiments on their own. The probability for success was therefore deemed quite high before commencing testing. The Hawthorne effect was also brought into consideration and was eliminated through taking two weeks before commencing testing. Feedback was received over a period of three months in order to gain better reliability and measurements regarding cost analysis and performance data were also strictly taken.

By implementing these innovation measures the bank has both increased customer satisfaction levels and drawn new customers. New processes are also now being utilised by many of the other banks due to their success in the test branches. What should also further be taken into consideration is the amount of learning that has taken place and the fact that staff turnover levels has substantially reduced during the experiential program.

5.3.2.3 Utilising external customer knowledge sources

Sawhney et al. (2003) argue that organizations need to compliment their direct interaction with customers with their knowledge about customers. Via the Internet organizations can make use of a multi-channel innovation strategy. Sawhney et al. (2003) suggest innomediaries as a channel to help organizations innovate more effectively. Three mechanisms are identified to make innomediation work:

- The customer network operator creates a link between the customers and the company. These innomediaries allow organizations to monitor specific customers through passive observation. Comscore is a company that has 1.5 million panellists who agree to have their Internet behaviour monitored. A company that wants more information about customers can therefore select the customer segment it wishes to track and continuously monitor their behaviour.

- The customer community operator forms the link between certain people with common interests and the organization. Thus when knowledge from customers is needed regarding product design, companies can then gain and share knowledge through a customer community operator. Opinion leaders within these communities further helps to create word of mouth for the organization. The automobile manufacturer Subaru utilises this type of innomediation though an organization called Edmund's who runs and hosts a private community for Subaru. Subaru employees participate and generate feedback from these communities and relate it to the product design manager or brand manager.

- The innovation marketplace links buyers of innovation with sellers of innovation through a shared innomediator. Eli Lilly is a pharmaceutical company that facilitates this exchange through a web sight called Innocentive. On this web sight researchers post problems that they have with their deadlines and the rewards for solving these problems. Innovators that have answers to the problems can then register as solvers and submit their solutions.

Innocentive has found that the rewards that are provided might be considered small but that they are viewed as significant in underdeveloped countries. The intrinsic incentives in solving a difficult problem also play a significant role. Sawhney et al. (2003) realises that these three innomediation mechanisms is not an all-inscribing list of the possible innomediators but it does provide better insight into the collaboration between customers and organizations in the innovation process.

5.4 Methods and challenges when utilizing customer knowledge

Research done by Davenport et al. (2001) reveals that firms require more than the transactional data of CRM databases to predict and understand the customer. A mix of transactional and human data results in the optimum balance that most firms seek to gain.

The organizations studied by Davenport et al. made use of seven practices to achieve the best results when managing knowledge:

- Place the focus on the most valued customers.
  Customer knowledge management techniques require valuable resources and there must be an understanding of which customers should receive the best services.

- Objectives should be prioritised
  Customer Relationship Objectives should be defined and then be prioritised according to the overall business strategy of the company.

- Discover the optimal knowledge mix
  Procter & Gamble make use of mental maps and focus groups to analyse customer thinking regarding products. Knowledge sharing takes place in both a face-to-face context and through utilizing databases.

- Utilise multiple databases
  A variety of customer data should be sought and integrated into a databank according to types of data that is obtained. Utilising one central database for all types off data still remains mostly unrealizable.

- Manage human knowledge creatively
  The leaders in the field of customer knowledge management were those who thought creatively about managing, both explicit (knowledge captured in databases) and tacit (knowledge transferred from person to person) human knowledge. Explicit knowledge for instance is captured in a database by Fidelity Investments when they make sales calls and is easily transferred when another account manager takes over from a previous one. Jeep in contrast captures tacit knowledge by employing sociology professors to track customer behaviour at rallies.

- Manage customer knowledge within a broader context
  Leading firms understand that the organizational structure as well as the culture of the workplace is important when aligning the organization with customer knowledge management objectives. Companies are also beginning to shift from a product centric

culture of innovation to a customer centric culture, which includes the whole customer experience.

- Work through a process and utilise supporting tools
  Organizations should manage customer knowledge around results and shift the emphasis away from only recognising transactional data as important, to also include other forms of knowledge about customers and customer behaviour.

Managers should further consider the two main challenges in customer knowledge management practices. The first is that of the cultural challenge an organization must undergo in thinking of the customer as a passive recipient to empowering the customer as a co-creator of knowledge. The second challenge is found in developing the correct competencies that are needed to enable the necessary interaction with the customer (Gibbert et al., 2002).

This agrees with research done by Bessellieu et al. (2001) that found two important requirements for a CRM ecosystem, the first requirement is connectivity and the second depends on the mindset of the company. Connectivity indicates to the processes and technology that connects companies and customers, while a Customer Relationship Management (CRM) mindset requires commitment to CRM in a business strategy that focuses on CRM.

5.5 Summary

Knowledge management has in the past decade increased in significance as a dynamic capability that can be utilised to discover new innovation possibilities and solutions to problems. Both explicit knowledge that resides in company databases and tacit knowledge, which resides with individuals, have been emphasised as important in the innovation process.

The differentiation between internal and external knowledge approaches has only recently gained attention, especially with the increased importance of the role of the customer and the management of customer knowledge in innovation. Internal knowledge approaches has analysed the transfer and combination of knowledge internal to the company, while external knowledge approaches recognises the value of the knowledge held by customers and the need to incorporate this knowledge in the innovation process.

Customer knowledge has been categorised into three main groups: Knowledge from customers, knowledge about customers and knowledge for customers. In the innovation process attention is mostly given to the first two groups. Knowledge about customers has in the past been regarded in the context of customer relationship management, where the customer has been viewed as a passive participant in providing information through transactions with the company.

Studies regarding knowledge from customers have analysed the customer as an active participant in the innovation process and have suggested that the competencies of the organization need to include the knowledge of the customer. Five different styles of Customer Knowledge Management have been classified to indicate the processes through which leading companies currently utilise knowledge from customers in creating value.

One of these styles of Customer Knowledge Management is the Community of Creation. This style makes provision for combining both an open and closed model of customer involvement in the innovation process. By keeping the community open enough to stimulate creativity and closed enough to maintain quality, organizations can enhance the chances of successful innovations. Various questions regarding this model with regards to the level of control, management of intellectual property rights, community involvement and the physical application of the model, still need to be researched.

Von Hippel (2001) has also studied customer involvement in the innovation process and argues that the involvement of lead users and user toolkits in the innovation process can enhance the chances of successful innovations, lead to a faster development time, as well as have cost benefits. Von Hippel argues that need - related information is situated with the customer, while solution - related information is situated with the supplier. Combining this information at the same time through use of a user toolkit enhances the speed and success of the innovation process. Other researchers on innovation have already demonstrated how user toolkits are currently being used in the financial services industry to add value for the customer.

Critics of customer innovation have indicated that customer innovation cannot be generalised to the retail environment and that the value of the customer's knowledge is overemphasised. These management thinkers have suggested that the knowledge customers have is based on their experience framework and that customers provide suggestions for new products based on these experiences. This problem has been labelled as "functional fixedness" which implies that customers find it difficult to suggest alternative ways of doing things. These critics have therefore argued that knowledge from customers can be utilised for continuous incremental innovation, but not for radical innovation.

Other managerial thinkers have argued that organizations should rather study the behavioural aspects of the customer and how the customer interacts with the organization. By understanding and observing the steps customers undergo in utilising products and services organizations can discover new innovation opportunities. Through the observation of customers in their own environment researchers can understand needs that customers experience but do not communicate. The example of Bank of America has provided an indication of how knowledge about customers and their interaction with the bank environment can be utilised to innovate services in this industry.

Innomediaries has also been viewed as a source to capture customer knowledge for innovation purposes. Innomediaries collect customer knowledge and sell it to organizations that require the needed knowledge. Innomediaries further enable the organization with the opportunities to connect with customer communities and observe customers in their interaction with the products or services of the organization.

Both knowledge about customers and knowledge from customers are important for continuous innovation. To enable the optimisation of customer knowledge, most organizations will need to undergo a change in mindset to regard knowledge flows throughout the relationship with the customer as significant. Organizations would also need to develop the required technological competencies to utilise continuous knowledge flows from customers when innovating their experience.

Chapter VI

Innovating the Customer Experience: Leveraging External Organizational Innovation Sources for Radical Innovation

6.1 Introduction

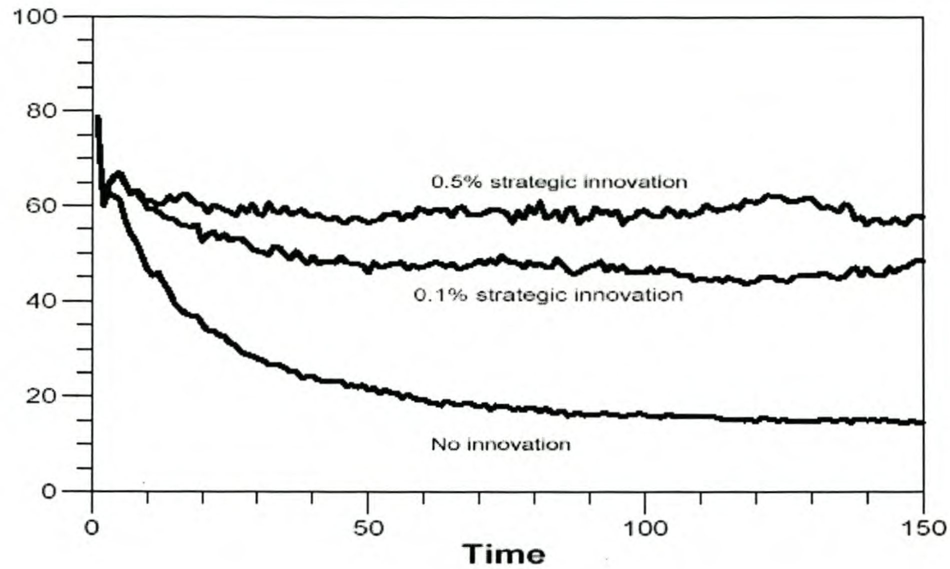
Chapter VI builds an argument for the necessity of organizations to incorporate external innovation sources to thereby enhance the recognition and exploitation of radical innovation opportunities. The chapter seeks to explain the necessity for interacting across organizational boundaries by reviewing current management theory on strategic and radical innovation. By developing a greater degree of interactivity organizations can connect with one another in order to co-shape (Leibold et al. 2003) their environment through non–linear strategic innovation.

6.2 Sustaining long term profitability through radical innovation

Research done by Larsen et al. (2002) has demonstrated that strategic innovation is needed to sustain organizational profitability over the long-term. Neoclassical economists have argued that over time industry profits converge towards a competitive equilibrium. In order to create abnormal profits disequilibrium is needed in the system, this disequilibrium only occurs when radical or strategic innovation takes place. To sustain above average profits organizations therefore need the ability to strategically innovate rather than imitate other strategies.

Hamel (1998) has suggested that incremental innovation is no longer sufficient to create wealth but that organizations should instead concentrate on creating non-linear innovation. In order to create non-linear innovation companies need to not concentrate only on innovating new products, but rather on innovation of the whole business model. The unit of analysis should therefore shift from the accentuation of products and rather concentrate on the whole business system. Hamel argues that organizations should not compete by doing the same things better but rather by doing things differently, instead of competing by the same rules organizations should seek to change the rules of the game.

Figure 6.1: The effects imitation and innovation have on organizational profits



Source: Larsen et al., 2002, 6

6.3 Radical innovation as antecedent of organizational self – renewal

Moore (1993) explains that when viewing the business environment a systemic approach is needed in which an organization is viewed as not only part of an industry but as part of the greater business ecosystem. "In a business ecosystem, companies evolve their capabilities around a new innovation (Moore, 1993, 76)." After a period of time a leader evolves in the ecosystem, which others follow and with which others vie for survival.

Moore indicates ecosystem development progressing through the four stages of: "birth, expansion, leadership and self renewal, or if not self renewal, death (Moore, 1993, 76)." In the fist stage organizations or entrepreneurs try to understand the needs and wants of the customer. The goal in this stage is to create the best value proposition for the customer. In the second stage, the expansion stage, competition for market share commences. Two conditions should be met before the expansion stage occurs: i) There must be a business model valued by a large amount of customers, ii) there must be the potential for growth in this market. In this stage organizations need to stimulate demand and try to expand accordingly.

In stage three of evolvement the bargaining power becomes more strongly situated with those that create the best value for customers. Constant innovation becomes of central significance for enabling ongoing value creation. Moore (1993, 81) indicates that certain companies in this stage hold the position of "central ecological contributor". This implies that other companies have a high dependency upon this company. The leader of the ecosystem takes the role of central contributor, which enables it to bargain for the highest share of value produced within the ecosystem.

In the fourth stage new ecosystems evolve that threaten existing business ecosystems through new innovations. This might also take place through new customer needs that shift because of the changing economic environment or other external factors influencing the ecosystem so that it becomes threatened by possible extinction. Self renewal is of critical importance in this stage and can only be done through "successive generations of innovation (Moore, 1993, 84)." There are three approaches companies can use towards self - renewal: i) Growth of new ecosystems can be inhibited. ii) New innovations can be integrated into the existing ecosystem. iii) Restructuring can be done to adapt and compete within the new environment.

Leibold et al. (2003) agree with Moore that organizations need to view their industry as part of the greater ecosystem in which they co-shape the environment with other organizations "by reacting to new business models or by proactively creating them (Leibold et al., 2003, 4)."

6.4 Exploring radical innovation opportunities across organizational boundaries

Kim and Mauborgne (1999) have suggested that organizations need to systematically look across organizational and industry boundaries to discover breakthrough innovation. By looking over these boundaries organizations can discover and create new market space in which to compete. Authors such as O'Connor and Rice (2001) agree that organizations need to be responsive to and dependent on external information sources when concentrating on breakthrough innovation. Wolpert (2002) further argues that in order for organizations to pursue radical innovation it has to explore external opportunities and cannot only remain internally focused.

Organizations need to look over various conventional boundaries to discover new market space in which to create value innovation (Kim and Mauborgne, 1999, 84):

- Organizations need to look across substitute industries:

  An example can be provided of how Intuit (the producer of the Quicken financial program) saw the pencil as their greatest competitor. Using a pencil was far more cost effective and easier than a financial program. Intuit noticed this and set out to increase the advantages of Quicken above that of the pencil. By lowering the price for their product and giving a functional and familiar user interface Quicken was able to compete by offering substantially superior value.

- Looking across strategic groups

  In most industries organizations form strategic groups that differ with other groups on price and performance. By looking across these groups organizations can perform in a market space that offers new value to customers. The Lexus automobile can be considered as an example of how Toyota captured value by competing against Jaguar, BMW and Mercedes through offering their customers substantially lower prices.

- Looking across the chain of buyers

  In most organizations the person making the purchasing decision could differ from the user of the product. There might therefore be a difference in the purchasers, users and influencers who interact with the organization. When organizations look across buyer groups they might find areas where they can create value in substantially new ways.

- Looking across complementary products and services.

  By understanding the total experience people are involved in when purchasing or using offerings organizations can redefine the scope of their offerings to create value by offering complimentary products or services.

- Looking across functional and emotional appeals to buyers

  A company such as SMH has turned a functional product such as watches into a fashion item to create an emotional bond with the customer. In the past customers used to buy only one watch, but now customers see the product as a fashion item and buy more than one watch to fit their image. Insurance companies in turn have focused on an emotional bond between the broker and the customer. Many of these companies are currently looking at the functional aspects of the offering and are utilising information technology to cut on costs and lower insurance premiums.

- Looking across time
  By understanding the influence trends might have on the value creation for the general population organizations can better understand methods in which new market value can be created. Kim and Mauborgne (1999) find this specific activity of looking across time to perceive value creation opportunities, as the most difficult way to find new market space.

Anand et al. (2002) have suggested that a larger amount of knowledge exists outside organizational boundaries than is located inside the boundaries of the organization. This necessitates organizations that strive for a competitive edge to locate and tap knowledge in the external organizational environment.

Anand et al. indicate three reasons that necessitate organizations to acquire external knowledge. Firstly because of the reduction of managerial numbers within the organization an increasing amount of knowledge is needed in decision making, fewer managers now require a greater amount of knowledge. Secondly, unexpected occurrences in the environment could rapidly reduce the novelty and usefulness of knowledge currently held by employees within the organization. Thirdly with the increasing significance of the high technology industry knowledge flows are currently being rapidly and unevenly spread across a various amount of smaller organizations. Two sets of activities are needed to develop the knowledge that the organization requires: i) Exploitation activities refer to recognising knowledge requirements that are needed for enhancement of current products and processes, ii) Exploration activities refers to those activities that seek to identify knowledge regarding products and processes that are revolutionary in nature and leads to transformation in the way in which business currently takes place.

6.5 Utilising the open innovation model to enhance radical innovation

Chesbrough (2003) argues that in the past big organizations that could afford their own R&D had the competitive edge over smaller organizations that first had to acquire the necessary resources to effectively compete. In the new economy there is a shift from a focus on centralised control of innovation to an open model of innovation.

The reason for this shift is firstly a rise in the amount and the mobility of knowledge workers, which makes intellectual capital increasingly more difficult to keep within the confines of the organization. Secondly new firms have been receiving increased funding from private venture capital, which enables knowledge workers to more easily start new ventures.

Currently knowledge workers with new ideas are not just bound to one organization but increasingly have the option of moving into the market and starting their own venture capital firm. In the open innovation model ideas that originate outside the firm can be implemented inside the firm. Open innovation also recognises the ability of entering markets outside the current boundaries of the organization. Through the knowledge economy the organizational boundaries have become more porous and that has led the locus of innovation to shifts more easily between the organization and the external environment.

Chesbrough (2003) warns that not all industries should be moving or will be moving to an open innovation model. An industry such as nuclear power energy, for instance, lacks the mobility of knowledge workers and the funds of the private venture capital company, to move in this direction. Chesbrough does however suggest that an increasing amount of companies are utilizing the opportunities offered through external innovation sources.

Linder et al. (2003) agree with Chesbrough that organizations are increasingly looking across organizational boundaries to assist with innovation. Not only are customers consulted in the innovation process but also research companies and other sources are considered. Companies have broadened their innovation sources to include various external sources in the innovation process. Procter and Gamble has recently appointed a director of external innovation and has changed its R&D slogan to "connect and develop" to indicate to their goal of incorporating innovation from external sources into the organization (Chesbrough, 2003).

Quinn (2000) accordingly argues that innovation solutions are becoming increasingly complex and therefore more specialised knowledge and skills are needed in the innovation process. External innovation sources have the advantage that specialised innovation sources can be sought and the innovation process is not as much confronted with the internal politics of the organization. Outsourcing innovation therefore provides greater access to innovation opportunities, increases speed in innovation processes and lower costs.

Chesbrough (2003) indicates that the attention organizations give to innovation can be placed into three areas: Funding Innovation, Generating innovation and Commercialising Innovation.

a) Funding Innovation

Within this area two types of organizations can be found:

- The innovation investor is an organization that has extended the R&D budget from research done inside the firm to also incorporate external venture companies. Not only do these investors help with funding but also with advice regarding growth of the organization.

- Innovation benefactors fund research at the first stages of the research discovery. In doing this they decide early in the discovery process if they want to incorporate the discovery into the organization and develop it further.

b) Generating Innovation

Four types of innovation can be found in this area:

- Innovation explorers are primarily focused on the discovery innovation stage.

- Innovation merchants focus on a certain set of techniques, which they codify and sell to the market.

- Innovation architects facilitate complex interaction within systems. Solutions to the systems are suggested and then these merchants set out to get buy-in from the other participants in the system.

- Innovation missionaries do so mostly to promote a cause and not as much for financial gain. Communities such as Linux software developers fall into this category.

c) Commercialising Innovation

This area consists of two types of organizations that focus on selling ideas on the market:

- Innovation marketers focus on understanding the market place and then bringing ideas from outside the organization into the organization to develop it and match it with the needs of the market place. Intuit has done that by bringing products such as Turbo Tax and Quick from outside the company and matched it with the needs of its current customers.

- Innovation one stop centres bring a broad range of ideas to the customer and adapt these ideas to the customer's specifications. Companies like Yahoo provides customers with the resources to make use of various ideas, which they can then, incorporate into their web page. Another example is IBM, which makes use of IT solutions from various vendors, which they then adapt to find the best solution for the customer.

Chesbrough (2003) observes that there are also fully integrated innovators that make use of the closed innovation model. Corporations that utilize this model keep the exploration, generation and commercialisation of innovation inside the organization.

Models may differ according to the industry; in some industries certain modes will be more affective than others. Organizations will need to extend their horizons and it might become necessary to move over the boundaries of the firm in order to develop the best results in the marketplace. Not only is there a need to develop ideas internally but there is also a need to develop external ideas inside the organization.

6.6 Systematically managing the sources of radical innovation

Linder et al. (2003) argue that vaster amounts of innovation sources have led to greater complexity in the management of innovation sources. Many organizations follow an ad hoc approach to managing innovation from external sources. This ad hoc approach does not follow a disciplined innovation agenda and therefore opportunities for leaning is lost along with valuable knowledge. With an uncertain innovation agenda, time and resources is further also unwisely spent. A well-defined innovation strategy is therefore needed to manage varied innovation sources.

Organizations studied by Linder et al. (2003) use a holistic approach to managing innovation and apply three organising frames in which decisions regarding innovation strategies are made. Organizations use the frames of Business Models, Scenarios and Product Domains to organise their innovation initiatives around. Traditional approaches of innovation management such as stage gate processes and portfolio management, should not be ignored, but can be adapted to bring refinement in the innovation agenda that the company uses.

To explain the methods in which organizations structure the innovation sources the term channels can be used. Channels can be conceptualised, as the methods organizations develop to match their innovation sources with their innovation needs. This assists organizations to manage these matched links as a group. Linder et al. (2003, 47) have identified five external innovation channels through which organizations can have access to innovation:

- Buying innovation on the market
  Innovation can be bought from universities and research labs that offer innovation for sale.

- Investing in Innovation
  Organizations seeking radical innovation can invest in venture capital or small organizations in order to resolve the "innovators dilemma".

- Co-sourcing
  Innovation initiatives that become too expensive for organizations can share the cost of innovation through co-sourcing. Nokia for example innovates in a consortium through technology standardisation boards such as GSM.

- Community sourcing
  In recent years organizations have increasingly started to gather innovation from user communities. EBay Inc. uses innovation from communities to discover new sales categories and to provide more options to customers.

- Resourcing
  Certain organizations contract research out when they demand certain talent or innovative tools. Companies can contract innovation initiatives or R&D to countries where salary scales are cheaper.

Managers should understand each channels strengths and weaknesses when choosing the channels to incorporate within their innovation sourcing strategy. Each channel can also be situated at different places in the innovation value chain of a company. Companies might therefore choose to incorporate innovation from universities at the early development stage or utilise user communities at the end-user stage.

Organizations that most successfully leverage innovation channels are those that match the correct channels with the strategic requirements of the organization. Lastly organizations need to set up the processes to implement and continuously evaluate the innovation channels and strategy. By setting up a team or a department to evaluate the innovation channels competitiveness and success, organizations can develop their capabilities in managing innovation sources.

6.7 Leveraging connectivity to enhance radical innovation opportunities

Ruggles (2002) has suggested that the rules of innovation are changing because of the high level of connectivity in the current ecosystem. Both technological and non-technological factors are leading to an increased level of connectivity, which is affecting the process through which innovation is managed.

From a complexity management perspective connectivity is analysed in terms of the agents of a system interacting across the system. This interaction leads to meaningful patterns of emergence or evolvement in the system. Too much connectivity in the system leads to chaos while too little connectivity results in inaction. Complexity functions most effectively on the border between chaos and stability (Kurtyka, 1999).

Ruggles (2002) further explains connectivity by arguing that when ideas of a homogeneous nature are combined it leads to increase in mass but does not result in the creation of something new. When ideas of a heterogeneous nature are connected it leads to the creation of something new. This argument is explained by noting that the combination of oxygen and hydrogen molecules creates something new and becomes a much more interesting combination than combining oxygen with oxygen.

Hage and Hollingsworth (2000) argue that connectivity takes the form of individual researchers, work groups and organizations interacting with one another across arenas. Through the intensity and frequency of the interactions tacit and explicit knowledge is transferred and when this is combined with diversity it results in the increased possibility of radical solutions. Connectivity itself does however not lead to innovation, and energy is needed in the system to direct and enable innovation. This energy takes place when barriers to connectivity are removed and when organizations stimulate inter-organizational collaboration (Ruggles, 2002).

In adaptive system's leverage points are variables through which a small stimulus leads to a much greater result (Kurtyka, 1999). Ruggles (2002) argues that by leveraging connectivity throughout the innovation process organizations can receive benefits in all the stages of the innovation life cycle. The management of connectivity is done through strengthening and weakening links between the organization and external organizations depending on the volatility in the external environment.

The management of business linkages is supported in research done by Eisenhardt and Gulanic (2000) who have argued that organizations should not focus on creating synergies but rather on a co-evolving strategy. In co-evolution, business units manage linkages according to their needs and the volatility of the external environment. By managing these collaborations correctly organizations can turn their organizations into an ecosystem that co-evolves on the competitive edge.

Rigby and Zook (2002) have indicated that an open innovation model is especially relevant in a volatile environment where organizations should seek to adapt and innovate without knowing the right direction to take. In this time the organization can investigate various innovation options and choose the best option relevant to them.

6.8 Summary

Managerial theorists have argued that long-term profitability depends on the ability of organizations to strategically innovate and not merely depend upon incremental innovation for success. To strategically innovate organizations should not only concentrate on product innovation, but rather holistically consider the whole business system as subject to change due to the innovation of individual business models.

Viewing the organization as part of the greater ecosystem can facilitate managers in understanding the need for self-renewal through radical innovation. Organizations that understand their development stage in the business ecosystem through the use of a systemic perspective are enabled to better sense when to utilise radical innovation for self-renewal. This systemic view requires organizations to systematically look across organizational boundaries and thereby enable value innovation. To gain a systemic perspective managers can utilise an open innovation model, which recognises the importance of various innovation sources in the innovation process.

Because of the increased value of knowledge and the subsequent empowerment of knowledge workers, innovation sources are currently not bound to the organization but have shifted to the external environment. To optimise these innovation sources necessitates systematic management through the development of an innovation agenda. This agenda requires the structuring of the sources of innovation into innovation channels through which organizations can match their innovation needs with external innovation sources.

When organizations properly leverage the connectivity of various linkages they can expect benefits throughout the innovation life cycle, they can also expect more effective opportunity recognition to enhance the organization's ability for strategic innovation to thereby co-shape their ecosystem.

PART THREE: DELIVERING THE CUSTOMER EXPERIENCE

Chapter VII

Delivery of the Customer Experience through Multi-channel Management

7.1 Introduction

Organizations in the financial services industry are currently faced with the need to radically differentiate their business models (Bansal, 2003), while simultaneously managing evolving needs that stem from the economical empowerment experienced by customers (Stein and Porrino, 1999).

To contest these issues financial services organizations are transforming their business models into models such as Bancassurance, Assurebanking, Allfinanz and Integrated Financial Services (Hislop et al., 2003) to leverage the organization's product portfolio and offer customers more choices (Bessellieu, 2001), but also to outsource processes that can be done cheaper and better (Bansal, 2003) by other companies.

By applying these new models, organizations have not sufficiently concentrated on the customer, but have instead remained product focused by concentrating on cross-selling initiatives. Models such as Bancassurance have been regarded as organizational strategies focused on enhancing cross selling opportunities, yet these models cannot be perceived as strategy, because they do not create differentiation (Hislop et al., 2003).

In order to successfully co-shape their ecosystem (Leibold et al., 2003) organizations in the financial services industry will have to enable linkages and collaborate in the formation of new business models (Bansal, 2003) through which they can constantly create differentiation. The strategy an organization chooses will have to be aligned with the organization's target market, while products should be sold according to customer segmentation (Hislop et al., 2003).

The delivery process of the organizational strategy will be dependent on the correct mix of the organization's distribution and communication channels (Hislop et al., 2003) and the ability of the organization to leverage customer connectivity, (Ruggles, 2002) through utilisation of touch points or channels, to create a differentiated customer experience (Bessellieu, 2001).

7.2 Defining multi-channel management

According to Stone, Hobbs and Khaleeli (2002) the definition of multi-channel management is "the use of more than one channel or medium to manage customers in a way that is consistent and coordinated across all the organizational channels or media used (Stone et al., 2002)". In the study of multi-channel management Stone et al. (2002) includes both delivery channels and communication channels. A multi-channel strategy also includes the management of touch points, which are the points where service takes place or products are bought. Multi-channel management has recently become increasingly important because of technological developments and because customers expectations and requirements for consistent treatment across all channels have increased.

McKinsey Marketing Solutions (Yulinsky, 2001) differentiates between a multiple channel strategy and a multi-channel strategy. A multiple channel strategy is the process of providing customers with multiple channels to interact with the organization. A multi-channel strategy optimises various channel interactions to provide cross-channel benefits. Research done by McKinsey indicates that the benefits derived from multi-channel propositions are i) a greater convenience through, for example, more personal services and the ability to receive information faster and ii) more personalised options through the ability to target customers with appropriate information.

Stone, Hobbs and Khaleeli (2002) have discovered seven factors that are causing companies to become attentive to multi-channel management:

- Customer demand is rising and customers have an increasing preference to use specific channels for specific types of interaction. Online channels may therefore facilitate information acquisition while product purchasing is done in the branch.

- Channel cost decreases when channel resources are integrated, this can improve the organization's channel cost structure. The mapping of customer usage can assist in further determining if channels are providing the required return on investment.

- From a customer perspective multi-channel management creates differentiation.

- Instead of customer relationship management, which tries to control the interaction between the customer and the company, customer-managed relationships places the control of interaction with the customer and views the nurturing of the relationship as the supplier's responsibility.

- Traditionally all the functions in the customer buying cycle were carried out with one channel, now many channels are involved within the same buying cycle. This creates the need to manage and control the buying cycle across various channels.

- In financial services multi-channel shoppers make up a huge part of the buying population. In the retail banking sector customers using multiple channels are between 25 and 50 percent more profitable than customers using only one channel. Correct multi-channel segmentation can therefore result in greater loyalty, but also improve the customer's lifetime value.

- Regulatory pressure in the form of decreasing costs of access also creates the need for multi-channel management. Through synchronisation of channels consistency of offerings can be achieved throughout all channels. Currently retailers do not deliver all the products online that they deliver in stores and in many cases companies only deliver a small selection of products online. To achieve consistency organizations should consider product rollouts online, firstly focusing on depth of the product category and then on the breadth. Services and promotions should further be integrated across all channels.

Integration of channels implies that in retail settings customers should be enabled to return goods to stores when bought online or use online coupons to make purchases at stores. Utilising multiple channels offers customers greater freedom and convenience in meeting their interaction requirements with the organization.

An issue that should not be neglected in multi-channel management is that of pricing. Research has shown that customers expect online prices to be competitive and therefore consideration should be given to pricing strategies (Stone et al., 2002).

Multi-channel organizations have until recently concentrated on cross-selling. When recognising the need of the customer, emphasis moves from cross-selling to cross-buying. Cross-buying concentrates on the needs of the customer to interact with the organization throughout the customer life cycle. When distribution channels are viewed by focusing on customer needs, it becomes important to keep products simple when selling them. By keeping product features low, the time of the sale can be reduced and confusion in the mind of the customer can be minimized.

Giving customers further opportunities by combining products and bundling offerings, might be an even better approach. Giving customers the opportunity to benefit from Bancassurance might also encourage customers to be more willing to share information (especially with regards to privacy issues). To encourage information sharing organizations should be able to provide a competitive offering that demonstrates to the customer the benefits of being able to bundle various products.

Problems Bancassurers are currently faced with in distribution are:

- The alignment and association of traditional channels around products instead of around customers.

- In various cases different channels functioning on their own target the same customer.

- Certain channels limit the spread of the customer relationship across various channels and instead guard the relationship as their own.

These problems should be resolved through:

a) ensuring the right mix of product and price across the different channels,
b) making sure the different channels has a good knowledge regarding their customer groups and sharing information and
c) referring customers to the correct channels for the best service according to their needs (Hislop et al., 2002).

7.3 Analysing the necessity for customer centricity in multi-channel management

7.3.1 Knowledge flows about customers: Utilising market segmentation

According to Hislop et al. (2002) most financial services have a deficiency in proper market segmentation. If segmentation does take place it is mostly using historical data based on single products. In insurance companies personal knowledge from agents is also rarely used to complement marketing segmentation and thereby enhance the creation of more tailored offerings.

Customising brands and tailoring distribution can be enhanced with correct customer segmentation. ING has used this approach to win clients and create cross-selling opportunities. They have called their multi-channel approach "face, call, click". In emerging markets ING use agents to meet customers "face-to-face". After the initial meeting the relationship is then extended through call centres and the Internet. In mature markets ING acquire customers through call centres and the Internet by offering competitive prices. The organization then provides the customer with the ability to choose the channels that are most convenient for him/her to buy and access products.

Creating customer scenarios has been suggested as a method to understand the buying habits of a customer. Saybold (2001) has argued that touch points are not the centre of the customer's experience but just a step in the process of achieving his goals. In order to extend relationships with customers, organizations need to find creative ways to reach into the lives of the customer. By envisioning the targeted customer's situations and activities, mapping them out and then finding common steps in these scenarios, organizations can best determine how and where to interact with their customers.

Nunes and Cespedes (2003) agree with this behavioural approach to customer segmentation. According to them customers are not remaining in the channels they have been categorised in according to demographic segmentation. Research has suggested that almost half of all customers utilise one channel to gain information and then utilise less expensive channels to buy the desired products.

The reason for customers utilising a variety of channels is that:
a) They have become more aggressive in hunting for bargains,
b) they have adapted to marketing strategies offering them certain advantages and
c) they have become empowered with a greater supply of information and knowledge.

With the advent of the Internet all customers were expected to shift their purchasing habits to Internet banking, yet currently the growth of traditional channels such as branches are just as high as that of new channels.

Segmenting customers into groups according to their shopping behaviour over all the available channels can provide marketers with a far better understanding of consumer needs at the different stages of the purchasing decision. For the most part customers undergo five stages in their purchasing decision:

- Awareness, customers become aware of the need for a product or service
- Consideration, information regarding the purchase is acquired
- Preference, alternatives are compared with each other and are evaluated.
- Purchase, the decision regarding how and where to purchase is made
- After sales services, that is concerned with contacting the customer to determine satisfaction.

Understanding the customer purchase behaviour across the whole purchasing process can enable the organization to meet the needs of the customer at all the different channels and do it profitably.

7.3.2 Managing knowledge flows from customers: Interacting with the customer

Prahalad and Ramaswamy (2003) have argued that customers should be involved in the process of creating their own personalised experience. Through the Internet customers are increasingly involved in dialogue with the organization and have become engaged in the creation of services and products. Prahalad and Ramaswamy (2000) argue that the difference between customisation and personalisation is important. Customisation occurs when the company designs a product to meet the need of the customer, while personalisation occurs when the customer helps to co-create their own experience.

Managing variety in the experience differs from managing product variety. In managing variety in the experience there is a shift from managing the range of a company's products to managing the customer interface. To provide the personalised experience organizations need to create the opportunities for customers to engage the company through multiple channels and then provide the customer with the ability to choose their own level of engagement. Communication with the customer therefore becomes increasingly important. The significance of communication needs requires the distribution and marketing channels of the organization to be integrated and managed so that the quality of the experience does not differ across the various organizational channels.

Research done by Vandenbosch and Dawar (2002) has indicated that companies desiring to become competitive should give consideration to the way by which they interact with their customers. Often customers value the interaction with the company more than what they actually purchase.

7.3.3 Enhancing knowledge flows: Designing the customer interface

Schmitt describes the customer interface as the "dynamic exchange of information and service that occurs between the company and the customer (Schmitt, 2003, 141)." This includes the information exchanged online, over the phone and in person. According to Schmitt the customer interface can influence the brand experience by enhancing or degrading it. The interface must correspond with the experiential theme of the organization and be formed around customer input. This input does not only concern historical data of customer transactions but also verbal input from customers.

The majority of organizations connect with their customers through three interfaces:

- Face-to-Face: This can be interaction occurring in stores, branches or through agents or sales men. With certain companies such as consulting companies interaction mostly occurs through this interface.

- Personal-but-distant: This interface is also tailored to the individual customer but differs from face-to-face, because the interaction does not take place in the same physical space. These interaction points are for instance the phone or the fax.

- Electronic: Interaction can take place here via the Internet, ATM or SMS. This interface might be viewed as personal but are in most instances mass produced.

7.3.4 Enhancing customer interaction by managing customer knowledge flows: The Royal Bank of Canada example

The Royal Bank of Canada has grown to be the biggest bank in Canada serving more than 10 million individual and business customers worldwide. Through utilising customer knowledge capabilities the bank has enabled customer specific strategies and leveraged these strategies through customer interaction technologies. By doing this the bank has been able to combine and distribute the most meaningful customer information to touch points as it is needed.

In the early 1990's the bank found that there were certain operational barriers to the implementation of a CRM strategy. They overcame this by moving routine operations out of branches to centralised sights. This centralisation increased the time employees had available for sales and services from 40% to 70%.

Royal Bank also segmented its customers into nine clear customer segments. This consisted of four business segments and five customer segments. Under these segments the bank currently also has hundreds of other various sub-segments that are used to enable more precision in sales and marketing efforts and to customise customer interactions.

Customer segment managers and product managers form cross-functional teams to understand the customer segments and sub-segments, these teams also share responsibility for profits and loss.

The bank strived to create consistency in all its interactions with customers throughout the various touch points. Face-to-face interaction was viewed as a greater challenge than other automated channels and to overcome this challenge applicable information was distributed to contact personnel to enable them to have consistency in dealing with customers.

Royal Bank of Canada views its main strategic advantage as the optimisation between the customer's needs and the banks objectives. "If customers do not emphatically make known their expectations of the organization, the bank attempts to predict what the customers expectations are, based on previous observed behaviour. This complex effort is essential to managing the customer experience effectively (Khirallah 2001, 8)."

7.4 The customer experience as the starting point for channel functionality

Stone et al. (2002) suggest that the customer experience should be the starting point whereby a channel's functionality should be determined. Customer scenarios, consistency and pricing are all important to the customer experience.

Gartner (Kirkby, 2003) agrees with Stone et al. (2002) by suggesting that the customer experience occurs at the touch points between the organization and the customer. The company needs to "just exceed" the expectations of customers at the touch points that are of importance to the customer and "just meet" the expectations of customers at the rest of the touch points (Kirkby, 2003). These touch points represent face-to-face contact with customers as well as contact through call centres and online contact. There should be a focus on the total customer experience, which is determined through every opportunity the organization has to deliver the brand value (Kirkby, 2003).

Schmitt (2003) explains that there are three main benefits for organizations when integrating the customer experience throughout all touch points:

- Integration differentiates a company because few organizations integrate effectively and proper integration captures the attention of the customer.

- Integration meets the emotional and intellectual needs of the customer thereby resulting in the customer having a better memory of the interaction experience.

- Integration can save the organization costs by not having different messages across various communication mediums that might produce cluttered communication.

7.5 Summary

Organizations in the financial services industry are currently required to differentiate from the competition while simultaneously addressing the economic empowerment of buyers. The correct application of multi-channel management can address both these needs.

Models such as Bancassurance, Assurebanking and Allfinanz have been suggested as strategies to deliver a multi-channel management approach. The inherent problem with these models is that they do not create differentiation and therefore these models cannot be considered strategic in nature.

Various organizations currently utilise multiple channel management to enable the customer to approach the organization through various touch points. Multi-channel management synchronises these touch points from a cross-buying perspective and leverages the organization's channels to enhance the offerings provided to the customer so that the customer can experience the benefits of multi-channel management. To enable these benefits organizations need to concentrate on customer segmentation not only in demographics but also in customer behaviour when involved with purchasing decisions throughout the customer lifetime.

To enable these benefits organizations need to apply customer segmentation not only through demographics, but also by segmenting customer behaviour in the purchasing decision throughout the lifetime of the customer. Organizations should not only consider knowledge about the customer as important, but the customer has to contribute to the organizational knowledge in order to personalise his own experience. Only through capturing knowledge flows from the customer through dialogue can the customer's desired level of engagement be determined.

The design of the interface between the customer and the organization should be determined by the experiential message the organization desires to communicate and by the input that the customer has in the personalisation of their experience with the organization. The Bank of Canada example illustrates how a bank can successfully utilise customer knowledge to manage the customer experience effectively.

In the design and innovation of the customer experience multi-channel management should be regarded as a management process for simultaneously determining the customer experience and enabling delivery of the customer experience. By enabling the above multi-channel management leads the customer to more effectively remember the organization through the differentiated experience that the organization provides.

PART FOUR: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

Chapter VIII

Summary, Conclusions and Recommendations

8.1 Introduction

The objective of this study was the development of a preliminary model for the leveraging of connectivity to innovate for a differentiated customer experience. The focus application area of the study concentrated on the financial services industry. This chapter presents the relevant model based on the conclusions that are drawn from the major findings of the study.

This chapter commences by providing a summary of the main findings of the study drawn from each individual chapter. From this summary the conclusions of the study are then drawn and presented in a preliminary model (Fig 8.1). Lastly the limitations of the study are described and recommendations are made with regard to further studies and the practical applicability of the study to the wider business environment.

8.2 Summary of the study

The summary presents the reader with an overview for each chapter, from Chapter II to Chapter VII.

8.2.1 Chapter II: The necessity for differentiation through innovation of the customer experience

In Chapter II the author of the study set out the key premises on which the subsequent chapters in the study have been built. These premises can be summarised into six arguments:

- Organizations in the financial services industry are required differentiate from the competition for competitive survival. To create the necessary differentiation, organizations should concentrate on innovative value creation.

- Value is created through innovation activities that should be leveraged in the areas of the back end and the front end of the organizational value chain.

- The value creation activities of the organization should be focused on creating differentiation in the experience the customer has in relation to the organization and not only in creating new products and services.

- Value is created by means of the connectivity or interaction the organization has with other organizations and with customers.

- Organizations should make sense of their environment and accordingly orientate the organization towards the most appropriate innovation approach.

- The organization's strategy should be applied and delivered through multi-channel management, which focuses on continuous value creation for the customer.

8.2.2 Chapter III: Describing the customer experience

Chapter III provides the reader with the background and scope in which to view the fundamentals of the total customer experience. This chapter regards the customer experience from different dimensions and analyses, including both the functional and emotional nature of the customer experience. The author of the study argues that organizations should partake in an experience audit to develop a distinctive experience motif that organizations can follow when focusing on innovating for a differentiated customer experience.

The chapter also seeks to build on previous research regarding the customer experience, analysing the concept of the customer experience as developing from a customer relationship management subcategory to a strategic priority. Viewing the customer experience from a strategic perspective provides the organization with greater understanding of organizational structuring and marketing areas concerning the customer's experience with the organization.

Viewed as a strategic priority the customer experience is regarded as a dynamic interaction process seeking to co-create value by connecting the organization to the customer throughout the innovation process.

8.2.3 Chapter IV: A review of extant theory regarding innovation management

In Chapter IV the author follows the development of innovation theory from an entrepreneurial perspective to a strategic perspective. The author indicates that the recent strategic theory of innovation has been recognising the differences between radical and incremental innovation, emphasising the need for organizations to manage for both short-term survival and long-term profitability.

Complexity management, as a relatively new field of management theory, provides deeper insight into how organizations can simultaneously manage for both incremental and radical innovation opportunities. This chapter describes how complexity theory conceptualises the organization as an open adaptive system that seeks to continuously innovate by functioning on the 'edge of chaos'. Functioning as an open adaptive system requires organizations to interact with the environment in order to shape and to be shaped by the environment.

8.2.4 Chapter V: Innovating the Customer Experience: Leveraging customer knowledge management for continuous innovation

This chapter emphasizes the importance of knowledge management in the innovation process. Knowledge flows have in the past been regarded as knowledge flowing internal to and in the organization, but relatively little attention has been given to external knowledge links and flows. Research regarding knowledge flows between the customer and the organization, through the innovation process, attempts to address this deficiency.

Research concerning knowledge flows from customers emphasizes a necessary shift in the locus of innovation, to include the knowledge owned by customers as a dynamic capability of the organization. Extant research in this area indicates that various leading organizations successfully manage the knowledge from their customers to create value in the innovation process. These knowledge management activities have been found to be relevant to the financial services industry.

Knowledge about the customer in the innovation process has also increased in importance and special significance has been given to the behavioural aspects of customers. An example of the Bank of America has been provided to explain how this knowledge about the customer can be leveraged to innovate the customer experience.

Utilising customer knowledge in the innovation process has been criticised by managerial thinkers as enhancing incremental innovation rather than resulting in radical innovation opportunities. Care should therefore be taken to not depend on customers for radical innovation opportunities, but rather consider customer input as significant for continuous incremental innovation opportunities.

8.2.5 Chapter VI: Innovating the customer experience: Leveraging external organizational innovation sources for radical innovation

This chapter revealed four findings with relevance to innovation management:

- Organizations not only need to innovate incrementally but also radically by strategically innovating and thereby transforming the entire business model of the organization.

- It is necessary for managers to have a systemic perspective to be able to innovate strategically. A systemic perspective can be gained by viewing the organization as a functional unit of a business ecosystem.

- An ecosystem perspective necessitates organizations to form linkages with other organizations. Through these linkages organizations can both influence other organizations and are influenced by them.

- Leveraging the connectivity of linkages (channels) can create benefits for the organization throughout the innovation life cycle, resulting in more effective opportunity recognition and the enhanced ability to strategically or radically innovate.

8.2.6 Chapter VII: Delivery of the customer experience through multi-channel management

In this chapter the author argues that multi-channel management should be recognised as a delivery mechanism. In the delivery process, the strategy of the organization assists the organization in synchronizing the customer experience, throughout the various touch points of the organization. Appropriately delivering the strategy of the organization through multi-channel management provides the customer with a differentiated customer experience in the interaction that occurs at the touch points of the organization.

In the application of multi-channel management the following points are of significance for the delivery of the customer experience:

- Managers need to view customer interaction from a cross-buying perspective instead of only a cross-selling perspective, thereby placing the focus on the benefits received by the customer rather than single-mindedly considering the benefits received by the organization.

- Customer segmentation should not only be applied through traditional demographic aspects, but also through consideration of behavioural aspects.

- Customers should be involved in the creation of their own experience. Organizations can create the opportunity for this involvement by managing knowledge flows between the organization and the customer.

- The interface between the organization and the customer should be designed in accordance with the experiential message the organization desires to communicate to the customer, and regarding the input the customer has in the personalisation of the experience.

8.3 Conclusions

This study concludes by restating the most significant findings of the study and providing certain recommendations based on these findings:

- Organizations in the financial services industry should differentiate by creating value through innovation activities.

- These innovation activities should be aligned throughout the organization and focused on differentiating the customer experience.

- Innovation activity should be concentrated at the front end and back end of the organizational value network.

    - At the front end connectivity should be leveraged through customer knowledge management to co-create value by continuously innovating the customer experience.

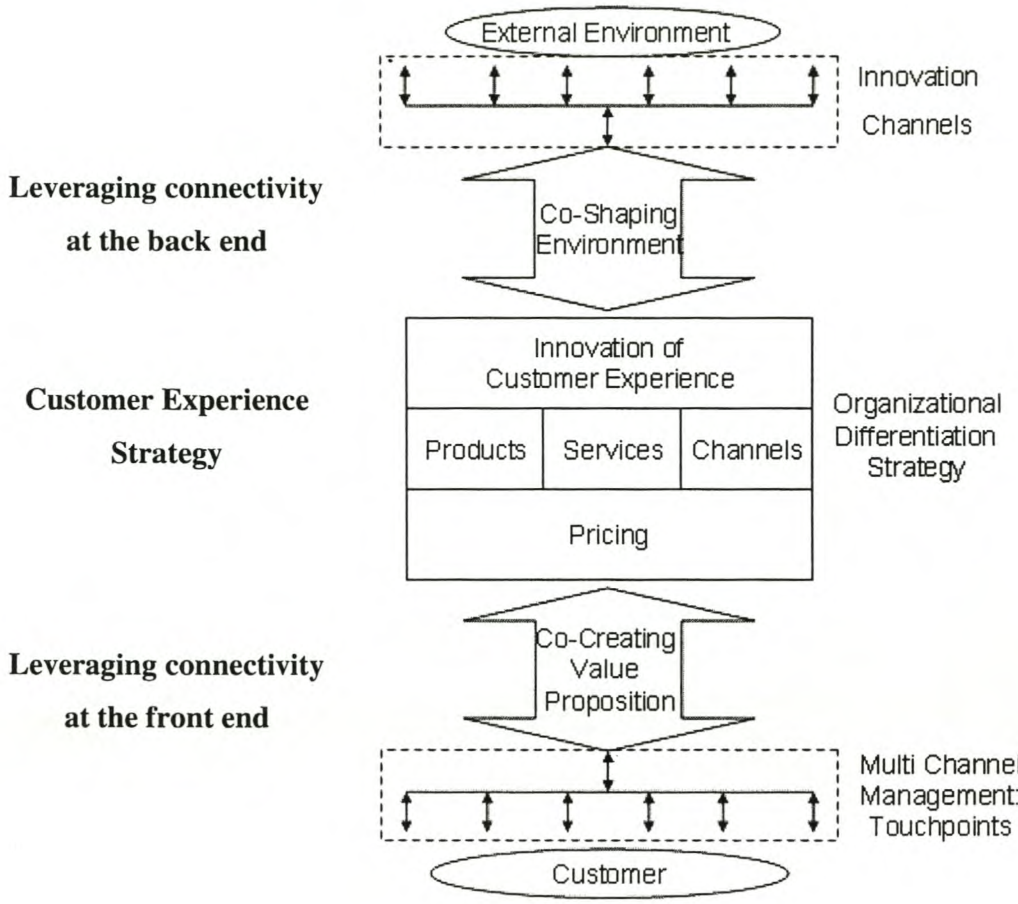
    - At the back end connectivity should be leveraged, by managing the innovation channels of the organization to provide the organization with access to sources for radical innovation, and shape the ecosystem of the organization.

- The organization's strategy should enable delivery through multi-channel management that creates a differentiated experience for the customer in the customer's interaction experience with the organization.

8.4 Preliminary model for leveraging connectivity to innovate the customer experience

The conclusion of this study is presented in figure 8.1, which illustrates how connectivity can be leveraged at the front and the back end of the organization to innovate the customer experience. According to Swahney and Prandelli (2000), the front end and the back end of the value network are where most of the value is created. This preliminary model (Fig 8.1) seeks to explain how interaction at the most important areas of the value network can add value to the organisation.

Fig. 8.1: Leveraging connectivity to innovate the customer experience



Source: Adapted from Sievewright, 2003

The model reflects three major dimensions of the organization:

a) At the back end of the organizational value network, management makes important decisions regarding outsourcing, alliances and joint ventures. Through these decisions the organisation is influenced by the environment, and conversely it exercises influence on the environment.

Through interaction by means of the innovation channels (Linder et al., 2003), connectivity is leveraged through knowledge flows to the organization and from the organization. This knowledge enriches and stimulates the innovation process that shapes the customer experience innovation strategy of the organisation. More importantly this connectivity across organizational boundaries leverages internal knowledge and leads to the consideration of radical innovation opportunities that can be utilised to sustain long-term profitability.

b) At the front end of the organisation connectivity is leveraged through utilisation of knowledge about customers and knowledge from customers in the innovation of the customer experience. Knowledge flows generated at the touch points with the customer should be utilised in the continuous innovation of the customer experience. Delivery of the experience should also be done at touch points by utilising multi-channel management to more effectively interact with the customer and enhance the customer experience.

Multi-channel management should therefore not view the customer through the customer's interaction with an individual channel, but rather holistically analyse the customer's experience when interacting with the organization through various channels.

c) The overall value proposition of the organization is determined in the customer experience. From the back end of the organizational value network, value is added through connectivity with external organizations by means of the innovation channels of the organization. From the front end of the organizational value network, value is determined through connecting with customers at the touch points of the organization by means of multi-channel management.

Value is determined in the experience the customer undergoes when interacting with the organization. The value in this experience is determined through innovation of the products, services, channels and overarching pricing strategy. In the holistic process of innovating the customer experience, thought should be given to the experience motif that the organization plans to deliver to the customer. All activities, but more especially innovation activities, undertaken by the organization can therefore more effectively be guided by taking the customer experience into consideration.

8.5 Limitations of the study

Limitations of the study can be found in three specific areas relating to the need for further research and practical applicability of the study's findings:

- The most prominent limitation to this study is that Fig. 8.1 provides a preliminary conceptual model that needs to be tested for validity. Further research is therefore needed to operationalize and test the model's validity and its applicability to the financial services industry and across various other industries.

- This study has been generalised to the financial services industry, but has mostly concentrated on banks and short term insurance companies. These companies have been chosen for their advantageous position to leverage connectivity through their utilisation of multi-channel management.

- Intellectual property and customer privacy considerations could also further limit the applicability of the model in different countries. Thought should therefore be given to information sharing regulations and activities when seeking to leverage connectivity in the innovation process. It should be considered that customers might be more willing to share knowledge when the benefits of knowledge sharing are directly experienced by the customer (Hislop et al., 2002).

8.6 Recommendations

Recommendations based on the results of the study can be categorised into two broad fields. Firstly recommendations are made regarding theoretical development and secondly concerning the application of the model to business practices.

8.6.1 Recommendations for further theory development

a) This study proposes a preliminary conceptual model which concentrates on the interaction of the organization across organizational boundaries throughout the innovation process. In this study the analytical review of innovation theory and chaos theory has revealed that cross-border interaction with other organizations and industries could lead to radical innovation opportunities. Specific research with regards to the relationship between cross-border innovation activities and radical innovation in the financial services industry could result in verification for the model proposed in this study. Due to the relative lack of radical innovation in the financial services industry studies of this nature might be considered difficult to conduct.

It is recommended that further research could beneficially focus on interaction between the mobile phone industry (Appendix A) and the financial services industry, as a proposed study field, to analyse the cross-border innovation activities in the innovation of the customer experience. This interaction could also result in possible radical innovation opportunities as suggested through this study.

b) Current research regarding the customer experience has mainly been conceptualized in the customer relationship management dimension. This overemphasis on customer relationship management has apparently led to an underdevelopment of theory regarding the innovation of the customer experience as perceived from an organizational strategy viewpoint. Prahalad and Ramaswamy (2003) have indicated that their study into the innovation of the customer experience is based on 'next best practices'. This provides an area of undeveloped study potential concerning the customer experience as an interactive innovation strategy of the organization.

c) A further recommended study field is the quantitative measurement and analyses of the customer experience. This can result in analytical tools whereby the organisation can measure the increase in value experienced by the customer. As stated by Prahalad and Ramaswamy (2003) the personalisation of the individual customer experience might currently not be practically applicable to all organizations because of technological reasons. Attention should therefore be given to analysing the experience of broader target groups.

In this regard segmentation of target groups should also focus on behavioural aspects. This is especially important because of the increasingly high significance of the interaction between the customer and the organization. This segmentation might also assist organizations in detecting lead users to facilitate in sustainable innovation initiatives.

8.6.2 Recommendations concerning the application of the study to the business environment.

a) In the past Porter (see Bachmann, 2002) has argued that cost leadership is not a successful strategy when an industry experiences a high degree of commoditisation. Organizations should therefore seek to compete either by focusing on niche markets or by offering superior value (Bessellieu, 2001). By developing and implementing a customer experience strategy, organizations are able to differentiate themselves from the competition through superior value added to the organization by means of innovation.

Organizations could gain benefits by quantifying their expenditure on innovation activities through conceptualising added value in terms of the gap between the perceived customer experience and the customer experience motif that is intended to be delivered by the organization. Further thoughts should also be given to mapping the experience of individual customers or broader target markets and directly relating the innovation activities of the organization to the enhancement and differentiation of the customer's future experience with the organization.

Studies undertaken by Kim and Mauborgne (2000) have suggested utilising the buyer–utility map as a method for reducing the uncertainties of innovation. This map is a combination of six stages in the buyer experience cycle, and six utility levers. Viewing new innovations through the use of the map provides managers with a clearer perception of unexplored innovation possibilities and supplies a tool through which managers can decide in which ideas to invest.

b) By focusing attention on the customer experience, organizations can be enabled to develop an understanding of how radical innovation opportunities might in the future benefit the customer in his or her future interaction experience with the organization. Following a customer experience strategy could therefore not only differentiate the organization from the competition, but also seek to guide the organization as to the decisions to make when seeking to innovate for an enhanced experience. Through gaining an understanding of how innovation activities benefit the customer experience, organizations can also improve their conceptualisation of the risks involved in the innovation activities of the organization.

c) As suggested in Part Three of the study the organization should seek to provide an integrated experience motif to the consumer by utilising multi-channel management activities. By providing an integrated experience the customer can also more effectively seek to differentiate regarding the competition.

Multi-channel management should further seek to integrate the channels of the organization so that different channels do not target the same customers when involved with cross-selling initiatives. Lastly, integration can also assist the organization to manage the customer's buying cycle when interacting with the organization.

Appendix A:

Leveraging connectivity between the banking and telecommunications industry

According to Rosingh et al. (2003) banks are currently under a new threat from competition in the telecommunications industry. The development in mobile technology appears to be a likely channel to grow in the future and provide telecommunication companies with the ability to enter the financial services industry.

Through increased development in mobile phone technology person-to-person and person-to-merchant payments are now enabled and the second generation of online financial services promises to be far more user friendly than current applications.

Telecommunication companies are currently searching for ways to leverage their customer base while simultaneously seeking ways to pay for costs spent on 3G licenses. It has been suggested that the mobile phone with its small screen lends itself more to the application of financial service transactions than to areas of entertainment. Paying bills, moving money among accounts and checking balances can ideally be done through mobile devices.

Retail financial services innovations often fail, because it requires customers to make changes in their behaviour. In this way on-line banking was deemed a much greater success, but customers still desired the ability to go to the branches for service.

Innovations also require the needed infrastructure to enable everyday transactions. The mobile phone industry can therefore both compliment the customer's life style through ease of use and the necessary infrastructure might already be in place to effectively utilise mobile technology.

Mobile phones have the added value above credit cards, in that accounts can be checked before purchases are made and mobile phones have more protection from unauthorised use than the use of credit cards. Access to prepaid credit is also enhanced through having immediate access to the account.

In Europe telecommunication companies and banks are now increasingly merging. This trend is also expected to shift to the U.S. markets. New payment methods that are enabled through these merges are expected to yield substantial profits above payment methods of today. Not only can cost reductions be expected from merges but also the promise of priority access to other products such as insurance policies and credit management services can lead to profit increases.

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